



**CONSULTATION ON
EXPOSURE DRAFT LEGISLATION:
ALTERNATIVE FUELS TAXATION**

Submission by:

Australian Institute of Petroleum

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(A) INTRODUCTION

The Australian Institute of Petroleum (AIP) was established in 1976 as a non-profit making industry association. AIP's mission is to promote and assist in the development of a sustainable, internationally competitive petroleum products industry, operating efficiently, economically and safely, and in harmony with the environment and community standards.

This submission has been developed to assist with the Treasury consultations on the implementation of the Government's alternative fuels taxation policy announced in the 2010-11 May Budget and on 7 September 2010.

AIP is pleased to present this submission on behalf of the following member companies:

BP Australia Pty Ltd
Caltex Australia Ltd
Mobil Oil Australia Pty Ltd
The Shell Company of Australia Ltd.

AIP is happy for our submission to be made publicly available on the Treasury website.

(B) OVERVIEW

- AIP supports the Government's announced 'tax policy' for all transport fuels of neutral tax treatment consistent with energy content.
- While AIP member companies expected to meet a 1 July 2011 start date for taxing alternative fuels as initially announced by the Government, AIP does not oppose the delay to 1 December; AIP member companies also expect to meet this revised timetable.
 - However, we strongly recommend that there be no further implementation delays.
 - AIP member companies have made investments and business plans on the basis of Government policy announcements on fuel tax since 2004, including on the basis of an announced start date of 1 July 2011.
- AIP has no significant concerns with the exposure draft legislation, as it largely reflects established AIP policy principles outlined in our Submission of 11 November 2010 and it aligns with the government's policy objectives (on the basis of the information currently available).
- However, draft regulations and other legislative instruments will give practical effect to this draft legislation and deal with other key matters for industry that are not considered in the draft legislation; therefore urgent release and consultation is needed on the draft regulations.
 - The regulations will deal specifically with the arrangements for blended fuel products and also provide the important link between excise payment/relief and meeting relevant fuel quality standards under the *Fuel Quality Standards Act 2000*.
 - They will also determine, among other things, the nature and extent of the business systems changes that will be needed to comply with the new tax arrangements.
- AIP has identified some implementation issues (related to LNG and CNG) and has suggested changes in relation to the draft legislation and supporting material (see over).
- While AIP has provided technical advice to Treasury on related fuels matters, independent advice from relevant experts should be sought, if required, on relevant technical gas issues.

(C) THE IMPLEMENTATION DELAY

AIP notes that the Government has decided to delay the introduction of taxation on alternative fuels by 5 months, from 1 July 2011 to 1 December 2011 and that this decision was made on the basis that *“it will allow the alternative fuels industry time to adjust to these changes”*. We also note that this delay will result in a cost to the federal budget.

AIP member companies will also be impacted by these taxation changes as significant suppliers of alternative fuels. AIP member companies expected to meet the longstanding timetable announced by the Government for a commencement of new arrangements from 1 July 2011 and had preparations already underway to achieve this. We therefore expect to meet the new start date of 1 December 2011.

We consider that the 5 month delay should be a sufficient period for other stakeholders in the industry to now make the necessary preparations. However, we strongly recommend no further implementation delays, as AIP member companies have made investments and business plans on the basis of Government policy announcements on fuel tax since 2004, including on the basis of an announced start date of 1 July 2011.

(D) THE IMPLEMENTATION APPROACH IN THE DRAFT LEGISLATION

AIP supports Treasury’s stated objectives of ensuring that the proposed legislation is practical, minimises compliance costs and delivers the Government’s policy in the most effective way. To help meet this objective, AIP made a comprehensive submission on 11 November 2010 (which is publicly available), outlining AIP’s detailed views and recommendations on how best to achieve these objectives through the implementation approach reflected in the legislation.

In particular, the 2010 AIP Submission noted that:

- (1) AIP supports the principle that all fuel for transport use - including liquid fuels (conventional fuels and biofuels) and gaseous fuels (LPG, LNG and CNG) - should be taxed on a comprehensive and neutral basis, to ensure the most efficient and robust tax system for road transport fuels.
 - AIP supports energy content as an appropriate and neutral basis for taxing all transport fuels and relief from the burden of excise being provided for ‘business inputs’ to production.
- (2) AIP supports the point at which excise should be imposed and collected should be at the highest point in the supply chain to ensure the most compliant fuel excise system. This approach is consistent with the current (successful) practice for liquid petroleum fuels, will reduce the number of licenses required, and will help ensure efficient market operation without undue burden on marketers/distributors to collect, remit and report excise to the ATO.
- (3) Consistent with the above overarching principles, AIP supports:
 - excise on all transport fuels being levied once it leaves the last licensed area (the point of ‘entry for home consumption’), with license holders being able to move product under permission between licensed areas free of excise;
 - any fuel exported should be exempt from excise;
 - any excise levied on liquid or gaseous fuel used for non transport purposes should be eligible for a Fuel Tax Credit (FTC) and business can claim FTCs for eligible transport uses;
 - for gaseous fuel sold directly to households, the process/principles covered in the ATO’s publication ‘Fuel Sold for Domestic Home Heating’ (NAT 15471) should apply; businesses who ‘package’ gaseous fuel for domestic use (eg. BBQ bottles) should be able to claim a FTC and pass through this benefit in their final price to customers.

- (4) AIP strongly opposes 'intended use provisions' (or imposing excise/customs duty on the basis of intended consumption). AIP considers it unreasonable for a fuel supplier to be expected to know what application a fuel product may be used for once it is sold to a customer (and determine whether or not to apply duty based on the intended use of the customer) and believe it will likely lead to significant compliance difficulties and revenue leakage.

The initial AIP Submission also emphasised that the current process of applying excise as fuels enter home consumption, then applying fuel tax credits as appropriate, has proved to be exceptionally robust in protecting the revenue base for Government, with an acceptable compliance and administration burden on the impacted parties. AIP considers there is a strong case for applying the same robust and efficient excise arrangements to alternative fuels from the start date.

AIP considers that most of these principles and recommendations are reflected in the exposure draft legislation, including removing the need for offsetting grants for gaseous fuels and biodiesel producers, and we have no significant issues with the exposure draft legislation; we consider it will likely meet the government's objectives overall, based on the information currently available.

However, there is one conflict with these principles reflected in the exposure draft legislation relating to the use of 'intended use provisions' (which AIP does not support nor has Treasury historically) for the levying of excise/customs duty on LNG and CNG.

- We note that the 2 June 2005 Treasury Discussion Paper (*'Review of the Excise Tariff Act 1921'*) indicates that *"imposing excise on the basis of intended consumption (use), an act that occurs after the taxing point, makes compliance difficulties inevitable. Indeed, parties have exploited this inconsistency over many years in the market, both on an opportunistic basis and in some cases, systematically and intentionally"*. AIP shares this assessment.
- The draft legislation proposes that automatic remissions under regulation will be available for prescribed classes of LNG and CNG. That is, no duty will be payable for LNG or CNG used for a range of non-transport uses.
 - While this approach was likely adopted here in the context of the low uptake currently of these specific gaseous fuels in the transport fuels market (and thereby the low risk currently of revenue leakage, particularly from fuel substitution between 'untaxed' and 'taxed' gas), this might not be the case in the future, particularly if this tax 'carve out' creates unintended consequences and makes compliance difficulties inevitable.
- As noted in our 2010 submission, AIP supports the principle that all transport fuels – including liquid fuels and gaseous fuels should be taxed in the same way consistent with (3) above.
- If the proposed approach in the draft legislation for taxing CNG and LNG is preserved in the final legislation, AIP considers that strict controls over remissions will be needed, as well as a robust compliance program, to ensure that revenue leakage to Government, and also industry compliance problems, are minimised. Historically, even with such controls, remission arrangements for liquid fuels still produced very significant compliance and revenue leakage problems and, because of these major flaws, remissions were replaced in 2006 by the current excise and fuel tax credit arrangements applying to liquid fuels which have proved highly robust and successful. The introduction of practices which have proven unsuccessful in the past is therefore not recommended.
- AIP also notes that if this taxing approach to CNG and LNG remains, it will create an inconsistency/inequity in tax treatment across gaseous fuels and between gaseous and liquid fuels, establishing a clear precedent for parties to seek the same tax treatment for other fuels used for non-transport purposes (eg. off-road diesel use for mining, farming etc).

(E) CONSULTATION NEEDED ON DRAFT REGULATIONS

AIP notes that the draft regulations and other instruments supporting the draft exposure legislation are yet to be publicly released. These regulations will deal with matters of direct importance to the industry, since they will outline how the legislation and arrangements will be applied in practice to specific fuels (eg. blended fuel products) and also provide the important link between excise payment/relief and meeting relevant fuel quality standards under the *Fuel Quality Standards Act 2000*. The regulations will also determine, among other things, the nature and extent of the systems changes that AIP member companies will need to make to comply with the new arrangements. AIP member companies will also need to review the regulations to ascertain the specific financial and working capital implications for their businesses from 1 December 2011.

Consultation on the draft regulations will therefore be critical, and AIP requests detailed consultation on these well in advance of the legislation being introduced. This will help to ensure that the regulations align with both the legislation and the Government's policy objectives, are robust, equitable and workable from an AIP member company perspective, and do not create unintended consequences and additional compliance and administration costs.

AIP's comments on, and support of, the exposure legislation is against this background.

(F) OTHER COMMENTS ON LEGISLATION & EXPLANATORY MEMORANDUM

AIP makes the following additional comments on the draft documents:

- The **definition of LPG** contained in the draft legislation appears appropriate and consistent with AIP advice; however, there is an inconsistency between this definition and the LPG definition in the Explanatory Memorandum (EM); the definition in the EM would mean that butane qualifies as LPG, which is inconsistent with AIP advice and our understanding of the policy intent.
 - AIP recommends the LPG definition in the EM mirror that in the legislation.
- The EM (under **section 1.52**) states that fuel tax credits will be available to certain manufacturers and distributors, enabling them to supply LPG into such tanks "GST free" (rather than "excise free").
- Part 1 of the *Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011* makes a number of amendments to definitions within The Schedule to the Excise Tariff Act 1921. AIP believes that the definition contained within paragraph (d) of the cell at table item 10, column headed "Description of goods", needs to be expanded so that it adequately covers gaseous products for use in refining petroleum condensate or stabilised crude oil. Consistent with AIP's principle of consistent/neutral tax treatment across all liquid and gaseous fuels (and our understanding of the Government's policy intent), we recommend the definition be changed to ensure that they are aligned.
 - Specifically, we suggest that item 3 of Part 1 of the *Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011* which amends the definition of LPG & LNG be expanded as follows:

"(including, for example, liquid petroleum gas and liquid natural gas), other than such products for use (other than in an internal combustion engine) in refining petroleum condensate or stabilised crude petroleum oil".
 - Such fuels and gases are an internal component of a manufacturing process, have a clearly defined/known use, and it is not technically feasible to make them available for entry into home consumption.

(G) TREASURY FOCUS QUESTIONS FOR INDUSTRY

LNG & CNG:

As noted in the 2010 Submission, AIP makes no specific comments in relation to the CNG and LNG technical matters identified in the Treasury focus questions.

- In principle, AIP believes that the appropriate unit of measurement and conversion rates should be those which are typically used commercially for these gaseous fuels at the point in the distribution chain where tax is to apply. We note that some form of standardisation may be required to take adequate account of variations in specification.
- AIP considers that such technical advice on these gaseous fuels should be sought from relevant independent experts.

LPG:

In relation to the Treasury focus questions related to LPG technical matters, AIP makes the following overarching comments.

- For excise to be imposed on a per litre basis at the point of entry into home consumption, the standard weight to volume conversion formula at a standard temperature and pressure should be used (as it is now).
 - AIP suggests the standard weight/volume formula (measured at 1 atmosphere and 15 °C temperature) should be used.
- Industry requires the certainty of a 'standardised conversion formula', including for excise and FTC purposes, due to systems requirements which automate the conversion process at the last licensed premises.
- Most of Industry is familiar with this standard conversion approach and applying it to calculate relevant litres and excise obligations.
- AIP considers that, if required, such LPG technical advice should be sought from relevant independent experts.

From the perspective of AIP member companies, and by way of general guidance, the application of these principles to the LPG focus questions would yield the following results:

- *Q1: What standard temperature or pressure adjustments are used by industry to calculate corrected volumes or weights of LPG, LNG and CNG?*
 - For LPG, the industry measures by weight, and converts to litres using density. The standard density adjustments typically used in the industry are as follows:

Propane:	1,965 litres per tonne
Butane:	1,730 litres per tonne
Autogas mix:	1,885 litres per tonne

 - The density adjustment for Autogas mix is an average which takes into account variations in the proportion of propane and butane (generally 60/40 or 50/50).
 - These density values are at 15°C temperature and 1 Atmosphere.
- *Q6. "What cents per kilogram rate for LPG corresponds with a rate of 12.5 cpl for LPG?"*
 - Given response to Q1, the following would typically apply:

Material	Litres per tonne	Excise (cents per kg)
Propane	1,965	24.56
Butane	1,730	21.63
Autogas mix	1,885	23.56

- Q7. “What conversion rate should be used to convert LPG sold in kilograms to litres?”
 - Given response to Q1, the following would typically apply:

Material	Litres per tonne	Litres per kg	Kgs per Litre
Propane	1,965	1.965	0.5089
Butane	1,730	1.730	0.5780
Autogas mix	1,885	1.885	0.5305

AIP RECOMMENDED APPROACH TO LPG EXCISE & FUEL TAX CREDITS

In the context of the above technical advice and consistent with Treasury’s exposure draft legislation, AIP recommends the following approach to calculating, remitting and claiming back excise on LPG. AIP’s suggested approach links directly to the LPG definition reflected in the current exposure draft legislation (which AIP supports). This definition defines LPG as having a composition ranging from 100% propane to an Autogas mix (a 50/50 or 60/40 mix of propane and butane), as this meets the current *Autogas Fuel Quality Standard*.

AIP recommends that the legislation/regulations:

- **Adopt a mid-point ‘density conversion factor’ between a band of 100% propane and an ‘average’ Autogas mix (given the relatively small difference in density variation);**
 - **AIP member companies generally accept that 1 tonne of 100% propane equates to 1,965 litres and 1 tonne of an ‘average’ Autogas mix equates to 1,885 litres.**
 - **The average or midpoint density is therefore 1,925 litres.**
 - **AIP member companies also consider that LPG density variance currently in the market falls within this band.**
- **apply that ‘single and fixed conversion factor’ (eg. one tonne of LPG is 1,925 litres) to all LPG entering home consumption at the prevailing excise rate - including each year of the announced transition period and once fully implemented.**

While there would be some variation in the density/composition of LPG in the market, it would still meet the definition of LPG in the tax law and would be consistent with the principle applying to liquid fuels of allowing for a density range. For example, the allowable density range for diesel is around 3%. Under AIP’s proposed ‘midpoint’ density approach for LPG, the potential density variation around the midpoint would therefore be lower (at 2%) than that for diesel.

Essentially, we propose that if a gas “is LPG” (as defined in the current draft excise legislation and *Autogas Fuel Quality Standard*) then a single conversion factor should apply for LPG excise and FTC purposes.

Under this approach, LPG excise payers and Fuel Tax Credit (FTC) claimants would know exactly what excise they will be paying, and claiming back where appropriate, at all relevant points in the LPG supply chain (and excise paid and the FTC claimable would be the same). Importantly, and in contrast to other approaches, there would be no requirement for LPG suppliers/distributors to invest in system controls to accurately track and report different compositions/densities of LPG that do apply at any given point and time in the supply chain (but within the band noted above).

We consider that this approach will meet the Government’s objectives and will deliver significant benefits in terms of simplicity and clarity and significantly lower compliance and reporting costs for industry. As a result, it will also have implementation benefits and likely lead to a much easier and smoother transition for the gaseous fuels industry in meeting the 1 December 2011 start date.