Comments on Treasury Discussion Paper

‘Fuel Tax Credit Reform’

by

Australian Institute of Petroleum

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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.

These comments have been prepared to assist the Treasury and the Australian Taxation Office in their finalization of legislation drafting and the development of administrative procedures related to fuel tax credit reform

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

OVERVIEW

AIP member companies support the general thrust of the proposed changes and note that several of the changes adopt proposals made in past industry submissions.

We confirm our request to review the draft Bill on a confidential basis, in order to identify any unintended consequences before introduction into Parliament.

AIP notes that the concepts embedded in the discussion paper are:

- Fuels are to be effectively taxed on the basis of their use, not their manufacture
- Fuels will be subject to excise and certain defined users and intermediaries will be eligible to reclaim excise payments through grants under a fuel tax credits scheme administered through the BAS
- Compliance responsibilities are to be aligned with claimants of fuel tax credits.

Adoption of these concepts by the Treasury and the ATO will have a number of practical impacts for AIP member companies in terms of commercial and accounting practices as well as sales (financial and volume) monitoring, reporting and compliance policies and practices. Since this will involve changes to the way some situations have been handled in the past, there will need to be changes to computing systems as well as operational procedures at many individual sites, we are seeking explicit clarification of a number of elements of the discussion paper.

Some of our proposals also reflect our unique position of being the remitter of the excise payments as well as the beneficiary of the fuel tax credits. In these circumstances, we see considerable practical benefits (such as substantially reduced administrative costs) arising if this special circumstance is recognised

CHAPTER 1

***Fuel used in burner applications and non fuel uses*.**

9 Some fuels, for example diesel, are more commonly used in an internal combustion engine designed to operate on that fuel. Other fuels, for example kerosene, are not normally used in an internal combustion engine, but are used for heating purposes as a burner fuel or in uses other than as a fuel. Kerosene can, however, also be used for powering an internal combustion engine. For this reason the equivalent rate to the diesel rate is included in the excise tariff for fuels that are suitable for use in an internal combustion engine, as a revenue protection measure.

14 In order that private users of these products will not have to enter the fuel tax credit system, a fuel tax credit will apply further up the supply chain with the benefit passed on in the price of the product, ensuring that the product is effectively fuel tax-free for these users. For products used as burner fuels, such as **kerosene** and heating oil, the distributor will be entitled to claim a fuel tax credit for fuel sold to a private household. For products used in non-fuel applications, such as kerosene used as a solvent, a fuel credit would be given to the packager of such products, packaged in small containers for resale in retail outlets.

Issue Jet and Kerosene are very similar and often interchangeable

We support the principle embodied in these paragraphs. However, we see a need to clarify how situations should be handled when fuel distributors sell a product acquired for a different purpose eg kerosene purchased duty paid as Jet but sold as kerosene for a non-transport purpose. Current practice is to “replace” the Jet sold as kerosene with a purchase of product entered as kerosene.

We expect to continue the current practice, except that the replacement product would now be “fully taxed”.

While this is a relatively minor problem, we believe it is important to establish a clear framework for this and similar exceptions to the general rule at an early stage of development of the new arrangements.

Fuel blends and their treatment.

The calculations envisaged in paragraph 28 are not sufficiently clear to enable the practical implications to be fully assessed. We ask that a worked example be provided to assist with our review of this section of the paper.

Fuel blends not suitable for use in an internal combustion engine.

30 Where a fuel blend is not suitable for use in an internal combustion engine, **the manufacturer of the blend** will be entitled to claim a credit for any fuel tax paid on the constituents of the blend. Some examples of these types of blends are cleaning solvents, paints and mould release agents.

We strongly support the introduction of a tariff and Fuel Tax Credit regime wherein there is simplicity and certainty for those who deliver the product into the excise paid market place and for those who distribute and market the product. (We note that this topic is also addressed in the Review of the Schedule to the Excise Tariff Act.)

However, we are concerned that, as drafted, the proposals may not be practical (as described below). A key concern is the need for a clear definition of what is a “non fuel blend or a blend that is not suitable for use in an internal combustion engine”.

We presume the manufacture of the 'fuel blend' would be an activity that would normally require an excise manufacturer's license and note that this is also addressed in the review of the Schedule to the Excise Tariff Act.

Problems

(i) Many solvents are simply rebrands of fuels

Most solvents are straight rebrands of petroleum products or have minor quantities of dyes/perfumes rather than being blends and could technically be used as fuels with little risk.

(ii) Mould oils

Some mould oils have very small proportions of other materials added. Some of these mould oils would do serious damage if used in internal combustion engines but others probably would not.

Some mould oils would have more identifiable quantities of additives but could be completely different in their potential for use in internal combustion engines, eg companies A and B may produce similar mould oils that have quite different impacts on internal combustion engines

Company	% Diesel	% other	Suitable for ICE ?
A	98	2	Not – clogs jets and filter
B	98	2	Works - but creates black smoke

It would be undesirable from a customer's perspective to have different fuel tax credit rules applying to the two products.

(iii) Some "Fuel Blends" have only minor fuel content

To the best of our knowledge it would be rare for a paint to be primarily (more than 50%) of petroleum content.

Possible solutions

In order to remove uncertainty, we suggest that there be coherent principles developed to cover the effective excise classification of petroleum/fuel products and blends that are not suitable for use in an internal combustion engine. This will necessitate further detailed discussions with ATO and Treasury on the detail of, and implementation of, these changes, from the perspective of fuel suppliers and product users. These discussions should involve other relevant stakeholders.

For example, we are concerned about the confusion likely to arise in considering whether 'fuel blends' are not suitable for use in ICEs. We suggest it would be clearer if the section referred to "use of fuels as a component in non fuel products" to ensure that excise payable on that usage is able to be recovered through a fuel tax grant (or to state that a credit is not available).

In other cases it may well be easier to tax such blends (eg those with very small amounts of additives) at the full rate applying to the fuels until their point of consumption.

In order to develop these principles, we suggest worked examples be prepared covering the specific products (including solvents, mould oils and paints) that may be regarded as 'fuel blends not suitable for use in an internal combustion engine' as they pass through the distribution and production chain – this would encompass

- Oil companies
- Distributors

- Packagers
- Blenders
- Manufacturers of solvents, mould oils, and paints and any other non-fuel products.

In each case we suggest that the general rule be applied that the end user or packager is the party entitled to the grant (similar to the arrangements applying to non blended products).

However, in the case of AIP member companies, where they are both the fuel manufacturer and also the packager, we suggest that our unique situation of being both an excise remitter and a fuel tax credit recipient be recognised by allowing the grant to be applied administratively as a net off to the excise rate. This would reduce the complexity of many of these non-fuel transactions which would otherwise require payment of excise on entry of the fuel component and then claim the fuel tax credit on that fuel component before the non-fuel blend passed to a customer. This approach would also resolve situations where non-fuel blends were produced prior to entry of the fuel component for home consumption

Claiming arrangements for fuel tax credits

37. Businesses will claim fuel tax credits on the Business Activity Statement in line with their reporting and claiming arrangements for the GST.

38. Administering fuel tax credits under the Business Activity Statement will streamline the payment of credits. It will also simplify and reduce business interactions with the ATO as businesses will have a single point of contact with the ATO.

39. When the fuel tax credit system is fully implemented, business entities will no longer need to estimate fuel use in various uses at various times according to complex and inconsistent criteria. This will lead to a significant reduction in record-keeping required to substantiate entitlements.

40. The extension of eligibility under the new arrangements will also reduce the need for businesses to clarify eligibility guidelines through costly negotiation and litigation.

41. Householders using fuel to generate electricity, and volunteer organisations not required to be registered for the GST using fuel in emergency vehicles, will claim fuel tax credits via a separate mechanism to the Business Activity Statement. Treasury and the ATO are currently exploring options for delivery of credits to these fuel users.

There is a range of circumstances where certain entities, such as SOFA participants, embassies, consulates, the Governor-General, etc, are eligible for access to ‘excise free’ fuel. We believe this needs to be dealt with specifically in the guidance notes to accompany the legislation. We suggest this be handled through the mechanism identified in paragraph 41, ie a mechanism separate to the BAS.

Claims for fuel purchased or imported under the Energy Grants (Credits) Scheme

42. Although the Energy Grants (Credits) Scheme will no longer provide a credit for diesel purchased or imported after 30 June 2006, certain claims under that scheme will be allowed until 30 June 2007. The claims must be for diesel that was eligible to receive a grant and purchased or imported prior to 1 July 2006 for use by an entity that was entitled to make a claim under the scheme.

43. Diesel purchased or imported for use in the period from 1 July 2003 until 30 June 2006 may alternatively be claimed as a fuel tax credit under the proposed Fuel Tax Act from 1 July 2006. The claim must be for diesel that was eligible to receive a grant and was purchased for use by an entity that was entitled to make a claim under the Energy Grants (Credits) Scheme.

44. A claim in respect of a particular purchase, importation or use of diesel may be made only once under either the Energy Grants (Credits) Scheme or the Fuel Tax Act.

45. A grant will continue to be paid under the Energy Grants (Credits) Scheme for the purchase for use of alternative fuels on-road until 30 June 2010. The amount of grant payments will be progressively reduced to zero in five steps commencing 1 July 2006 and ending on 1 July 2010.

We believe the mechanism identified above gives rise to potential excess claims in relation to fuels purchased prior to 1 July 2006 but claimed under the new Fuel Tax Act. As an example, Specified Diesoline used for burner applications attracts a credit of 30.586 cpl under the Energy Grants Credit Scheme but would appear to attract a full credit of 38.143 cpl under the Fuel Tax Act.

It is suggested that the transition mechanism in the Fuel Tax Act should provide for claims to be made on fuels purchased prior to 1 July 2006 but only to the extent of the credit available for the fuel under the Energy Grants Credit Scheme.

CHAPTER 2

The Fuel Tax Act

1. Fuel tax credits will be delivered within a taxation framework, rather than as a grant as is presently the case under the Energy Grants (Credits) Scheme.

2. The Fuel Tax Act will be the means of providing fuel tax credits to business from 1 July 2006 and, in the future, will establish a uniform system for the taxation of fuels, both locally produced and imported, commencing with the taxation of gaseous fuels[4] from 2011.

3. Under the Act, fuel tax relief will be provided in the form of a fuel tax credit for the fuel tax embedded in the price of the fuel. This fuel tax credit will be claimed on the Business Activity Statement and will be offset against an entity's other tax liabilities.

We understand that the Government has taken a decision, in principle, to establish a uniform system of taxation of fuels along the lines identified in paragraph 2. We would expect there to be a series of detailed discussions with industry about the practical aspects of implementing this decision closer to 2011. In particular, we would need to have a clear joint understanding of the implications of the changes from the principles embodied in the Excise Act (see also comments on Chapter 3 paragraph 3.)

CHAPTER 3

Coherent Principle 2 ***Business use of taxable fuels (page 13)***

Principle

You are entitled to a fuel tax credit for taxable fuel *that you acquire*, or import into Australia, to be consumed in carrying on your enterprise.

We suggest that this principle be is clarified to the effect that credits are in respect of duty paid fuel ie that a user buying product under bond would not be entitled to a credit unless and until duty was paid on that product.

Since there will be instances of "own use fuel" we also wish to have certainty that a credit will be available in respect of that fuel if excise has been paid on that fuel.

We suggest the following restatement of the principle

You are entitled to a fuel tax credit for *duty paid* taxable fuel *that you acquire by purchase or through own manufacture*, or import into Australia, to be consumed in carrying on your enterprise

Add-on: ***Fuel sold for private use other than in an internal combustion engine***

4. You are entitled to a fuel tax credit if you sell fuel to a private household for use as a burner fuel in heating applications, or if you package fuel for non-fuel uses in containers of a defined capacity for resale in a retail outlet. The Treasury discussion paper, *Review of the Schedule to the Excise Tariff Act* seeks industry views on the appropriate container level under which use of fuel for non-fuel purposes is essentially private use. That paper will be available shortly.
5. The use of fuel in private applications such as heating and non-fuel uses will be effectively fuel tax-free. A fuel tax credit will be provided to the sellers and packagers of the fuels rather than requiring the private users to register to claim the fuel tax credit. It is expected that the fuel tax-free status of these fuels will be reflected in the price of the fuel to the private end user.

We agree with the general principle that packaged fuels for non fuel uses should be effectively free of tax. The notion that it be limited to product for resale in a retail outlet creates a level of complexity that would be impossible to manage since the packager has no control over whether the product is ultimately sold in a retail outlet or otherwise and whether the customer intends to use the contents of the package for fuel or non-fuel purposes. It would appear that the only practical approach is to apply the same rule to all packaged product i.e delete the words "for resale in a retail outlet"

We note it appears that the arrangements described in Figure 2 of the Review of the Schedule to the Excise Tariff Act do not provide any fuel tax relief on packaged fuels sold to non business users for use other than in an internal combustion engine – that appears to be contrary to the Government's undertaking (ref page 99 of Securing Australia's Energy Future).

In view of the impossibility of differentiating according to customer type, some refinements need to be considered in relation to fuel types covered under this provision. Given that the package size limit will probably be about 20 litres, it seems that making heating oil and kerosene sold in containers of less than 20 litres effectively tax free would be reasonable. However, it does not seem appropriate to make diesel and petrol sold in such containers effectively tax free as they do not have a significant use as burner fuels in a domestic context.

We strongly support the notion that distributors will claim the fuel credit for product acquired by them for sale to private households in heating applications. However we believe it is essential there be explicit controls and agreed procedures in place from the introduction of the new legislation to ensure that opportunities for fuel substitution are precluded.

We suggest that such controls should include:-

- Only entities registered with the ATO for that purpose would be entitled to claim for that purpose.
- Claimants would be required to maintain records of eligible fuel bought, held and sold.
- Claims made would be reconciled against stock records by claimants.
- Claimants would be required to maintain records of sales sufficient to identify for each sale
    - Date
    - Product
    - Volume
    - Customer name
    - Customer address
- Claimants would be required to maintain records of sales sufficient to identify for each customer
    - Name
    - Address
    - Storage capacity of customer tank
    - Monthly sales volumes

A penalty mechanism will also be needed to quickly stop any substitution practices that emerge. One option might be that failure to maintain such records should entitle the ATO to cancel the distributor's right to claim such fuel credits

Carve out 2.2 ***Use of fuel in a vehicle with a gross vehicle mass of less than 4.5 tonnes in travelling on a public road***

We understand that the criteria covers all "vehicles with a gross vehicle mass (GVM) of at least 4.5 tonnes" , with no requirement to consider the use to which the vehicle is put other than that is used on road. eg. a fork lift would qualify if used on road. We also understand that incidental use associated with an eligible vehicle (as compared to incidental use of the vehicle itself) (e.g. fuel used in a stand alone refrigeration unit engine on a qualifying truck) would qualify.

We seek confirmation that these interpretations are correct, in the interests of both our own use of fuels and that of our customers.

The discussion paper does not appear to encompass other currently legitimate incidental uses, such as driving a mining vehicle into town for repairs, and other similar infrequent trips.

It is important that there be no "black holes" – neither on road nor off road. We suggest that an appropriate coherent principle would be that 'all business use attracts either an off road or on road credit unless it is used to power a vehicle of less that 4.5 tonnes GVM traveling on a public road'.

Coherent Principle 4: *Working out how much fuel tax credit is payable on the fuel*

Principle

The amount of your fuel tax credit is the amount of effective fuel tax that was payable on the fuel.

Unfolding

39. For a business, the effective fuel tax payable is worked out by assuming that the fuel tax has been calculated on the fuel at the rate in force at the start of the tax period in which you acquire or import the fuel.

40. For private users of fuel, the effective fuel tax payable is worked out by assuming that the fuel tax has been calculated on the fuel at the rate in force at the beginning of the financial year in which the claim is received by the ATO.

The document makes it clear that the credit will be calculated assuming the rate in force at the beginning of a tax period. This will disadvantage claimants where there is a rate increase during the claim period. For example, if the excise rate increased on 15th January, an annual claimant would be forced to use the rate applicable on 1 January for the whole claim. This is clearly a disadvantage and arguably unfair, and may also push annual and quarterly claimants to elect to move to a monthly BAS cycle (contrary to the ATO's policy of reducing administration). We suggest that Treasury give this matter further consideration – perhaps claimants could be given at least the option of calculating the credit based on actual rates (if they are prepared to do the extra work), or the ability to use an average rate (that could be set by the ATO to avoid contention about how it was derived).

Carve-out 4.1: *Fuel tax imposed to fund a cleaner fuel grant*

48 **You** must reduce the amount of your fuel tax credit by any fuel tax that is imposed to fund a cleaner fuel grant.

The claimant is not required to reduce the credit; the claimant simply claims the relevant amount. It is up to Government to determine the amount of grants in accordance with policy.

It seems that this might better said as, “Fuel tax credit rates will reflect both the excise applicable to products and the cost of grants allowed to encourage the production of cleaner fuels.”

Carve-out 4.2: *Fuel tax offset by a cleaner fuel grant or production subsidy*

51. You must reduce the amount of your fuel tax credit by any cleaner fuel grant or production subsidy that reduces the effective fuel tax paid on the fuel that has been paid or is payable for the fuel.

52. **Note**: This reduction reflects the fact that the subsidy is a partial return of the fuel tax embedded in the fuel, reducing the amount of fuel tax effectively paid on the fuel.

We understand that these paragraphs refer to fuels other than motor spirit and diesel. We suggest that this be clarified by way of reference to some of the fuels envisaged to be in this category.

Carve out 4.3 *Entitlement to a drawback of duty* (page 21)

We understand that the reference to “a draw back of duty” should be taken to cover “drawback, refund, rebate or remission of duty”.

We suggest that there should be further consultation on this aspect, using a series of worked examples to ensure that practical implications can be identified. In particular we seek examples of the interactions between customs duty, excise, and fuel tax credits in the context of shipping industry activities.

Coherent Principle 6 Where there is no prospect of the fuel being used (Page 22)

Paragraph 65 as written denies credits where we believe they would be reasonably due e.g. normal operational losses. We suggest that the principle needs to indicate that credits are available for fuel used in the business including operational losses.

CHAPTER 4

Third party claiming arrangements etc **(**Paragraph 3**)**
We understand that the E-grant system is to be terminated with the introduction of the Fuel Tax Credit reforms.

E-grant was implemented by the oil companies at a very significant cost at the urging of the ATO. It is disappointing to see that this system is now being terminated and industry investment has been to little avail.

Before we terminate our systems, we request further discussions with the ATO about possible future ATO requirements for such information for populating claimants' BAS documentation.

Attribution and Invoice requirements **(**Paragraph 12**)**
We note that S29-10 of the GST Act also requires that a tax invoice be held.

Special provision is required for those instances where a tax invoice is not required e.g. use of own manufactured product or product previously bought under bond.