



**Australian Government**

# Implementation of alternative fuels taxation policy

Discussion Paper  
October 2010

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## CONSULTATION PROCESS

### Request for feedback and comments

The Government is seeking your feedback and comments on the implementation issues raised in this paper. Submissions may address one or more specific focus questions contained in the paper and identify any other issues which may be relevant to the implementation of the policy. While submissions may be lodged electronically, by post or by facsimile, electronic lodgment is preferred.

All information (**including name and address details**) contained in submissions will be made available to the public on the Treasury website unless respondents indicate that they would like all or part of their submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submissions to remain in confidence should provide this information **marked** as such in a separate attachment. A request made under the *Freedom of Information Act 1982* to make available a submission marked 'confidential' will be determined in accordance with that Act.

### **Closing date for submissions: 12 November 2010 (close of business)**

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## FOREWORD

I am very pleased to release this discussion paper on the implementation of the alternative fuels taxation policy.

In a joint press release on 13 May 2010, the former Assistant Treasurer and the Minister for Resources and Energy confirmed that the Government would implement the longstanding plan for energy content based taxation of alternative fuels. This plan includes a 50 per cent tax discount for alternative fuels such as biodiesel, ethanol and the gaseous fuels, including LPG. At the same time the Government also announced a new staged phasing in of the regime to allow the ethanol industry time to adjust, rather than the sudden change that would have occurred under the 2003-04 Budget policy.

On 7 September 2010, the Government announced a revision of the phasing in of the taxation regime for ethanol. The revised arrangements involved a more gradual implementation of the policy to phase out grants for domestically produced ethanol. This longer transitional path for domestically produced ethanol will assist the industry to plan with certainty for the future and prepare for the longer term, in which the same arrangements will exist between domestically produced ethanol and imported ethanol.

The longer transition path for domestically produced ethanol recognises the importance of fostering a well established and efficient Australian ethanol industry and the potential environmental, energy security and regional development opportunities that it can create.

The Government looks forward to receiving the industry's views on the implementation of the alternative fuels taxation policy.

**Assistant Treasurer and Minister for Financial Services and Superannuation**

The Hon Bill Shorten MP



# 1. INTRODUCTION AND OVERVIEW

## 1.1 INTRODUCTION

This discussion paper provides details of the Government's alternative fuels taxation policy announced in the 2010-11 Budget and subsequently on 7 September 2010. The paper seeks the views of stakeholders on the implementation details of that policy to ensure that the proposed legislative framework is practical, minimises compliance costs and delivers the Government's policy in the most effective way.

The paper allows stakeholders the opportunity to identify matters that may arise with the implementation of the policy and the design of the legislation.

The paper also raises a number of specific questions on which comments are sought.

## 1.2 OBJECTIVES OF REFORMS

The key objectives of the reforms are to:

- (a) introduce greater consistency in the taxation of fuels used for transport purposes to ensure that competition between untaxed transport fuels and currently taxed fuels does not harm economic efficiency and create distortions;
- (b) provide certainty to industry; and
- (c) phase in the new fuel tax arrangements while providing support to the alternative fuels industry in recognition of the potential environmental, fuel security and regional development benefits that these industries can generate.

## 1.3 TIMETABLE FOR REFORMS

The reforms will apply from 1 July 2011.

Treasury will conduct targeted consultations with key stakeholders in October and November 2010. The draft legislation will then be made available for public consultation, prior to its introduction into Parliament in the first half of 2011.

## 2. CURRENT TAXATION ARRANGEMENTS FOR FUEL

1. The current taxation arrangements for fuel impose excise on certain domestically manufactured fuels and excise-equivalent customs duty on relevant imported fuels. Fuels subject to fuel tax include petrol, diesel, fuel oil, kerosene, benzene, toluene, xylene, biodiesel and fuel ethanol (ethanol).
2. The legal incidence of fuel tax falls primarily on the producer or importer of the fuel.
3. Currently, the general rate of fuel tax applying to most fuels is 38.143 cents per litre.
  - (a) However, in the case of biodiesel, although excise and excise-equivalent customs duty of 38.143 cents per litre applies, there is also a grant payable of 38.143 cents per litre under the Energy Grants (Cleaner Fuels) Scheme for both imported and domestically produced biodiesel which meets the relevant fuel quality standards in the *Fuel Quality Standards Act 2000*.
  - (b) In the case of domestically produced ethanol, excise of 38.143 cents per litre is payable and there is also an entitlement to a grant under the Ethanol Production Grant Program. Imported ethanol is currently subject to excise-equivalent customs duty at 38.143 cents per litre (and ad valorem duties of customs up to 5 per cent depending on origin) but there is no entitlement to a grant.
  - (c) Methanol and the gaseous fuels, including liquefied petroleum gas (LPG), liquefied natural gas (LNG) and compressed natural gas (CNG), are currently outside the fuel tax system and are thus excise free.
4. The goods and services tax (GST) applies to the excise-inclusive price of petrol and diesel at a single uniform rate of 10 per cent.
  - (a) GST also applies to the biofuels and the gaseous fuels.
5. Fuel tax credits partially or fully offset the fuel tax incurred by eligible businesses.
  - (a) Similar to GST input tax credits, the purpose of the fuel tax credit system is to avoid distorting business investment decisions and behaviour that would occur if business inputs were taxed.
  - (b) Fuel tax credits provide a credit for the fuel tax (excise or excise-equivalent customs duty) included in the price of fuel used for business activities in machinery, plant, equipment and heavy vehicles. Fuel used in light vehicles of 4.5 tonne gross vehicle mass (GVM) or less travelling on public roads are not eligible for fuel tax credits.
  - (c) Subsection 43-5(4) of the *Fuel Tax Act 2006* provides a special method for calculating fuel tax credit entitlements for petrol and diesel blends which meet the petrol or diesel fuel standard under the *Fuel Quality Standards Act 2000*. Blends which meet these standards receive a credit as if the blend wholly consists of petrol or diesel and qualify for a full fuel tax credit even though the biofuel component of the blend already benefits from an equivalent grant, and, after 1 July 2011, will pay discounted excise. Blends that do not meet the fuel quality standard for petrol or diesel are only eligible for a fuel tax credit equal to the fuel tax paid less the applicable grant on each component of the blend. Appendix A provides further information on fuel tax credits.

### 3. THE 2003-04 BUDGET POLICY ANNOUNCEMENT

6. The fuel tax policy announced by the then Government in the 2003-04 Budget was to tax all fuels on an energy content basis but with a 50 per cent discount for alternative fuels. The timing of the changes was revised in the 2004-05 Budget. Under the announced changes, biodiesel, ethanol, methanol and the gaseous fuels were scheduled to begin incurring effective fuel tax from 1 July 2011. All fuels were to have tax levied on an energy content basis consisting of high, medium and low bands, and the alternative fuels were to receive a 50 per cent reduction on their respective energy content fuel tax rates.
7. These taxing arrangements for alternative fuels were to be phased in with Energy Grants (Cleaner Fuels) Scheme grants that would be phased down from 80 per cent of the tax from 1 July 2011 to zero by 1 July 2015.
8. Parts of that policy have been legislated. However, the following principal components of the policy are still awaiting legislative implementation:
  - (a) gaseous fuels and methanol are to be brought into the fuel tax regime;
  - (b) fuel tax is to be levied on an energy content basis; and
  - (c) alternative fuels are to receive a further 50 per cent reduction on their respective excise rates.
9. The consequences which would automatically flow from 1 July 2011 in the absence of further legislation to implement the announced policy are outlined in Appendix B.
10. Therefore the arrangements to be legislated by 1 July 2011 are as follows:
  - (a) The gaseous fuels, comprising LPG, LNG and CNG and methanol, will be brought into the new tax arrangements with revised grant arrangements to apply to ethanol and biodiesel.
  - (a) Fuel tax rates will fall into one of three energy content bands — high (energy content greater than 30 megajoules per litre), medium (between 20 and 30 megajoules per litre) and low (less than 20 megajoules per litre).
  - (b) The tax rates on the bands will be set as a proportion of the fuel tax rate for petrol and diesel at a rate of 100 per cent, 66 per cent and 45 per cent respectively.
  - (c) Alternative fuels will receive a further 50 per cent reduction on their respective fuel tax rates to reflect the potential environmental, energy security and regional development benefits of these fuels.
11. The table below shows the transitional and final fuel tax rates for alternative fuels under this policy.

**Table 1: Net fuel tax rates for alternative fuels in cents per litre (excluding ethanol)**

Fuel type	From 1 July 2010	From 1 July 2011	From 1 July 2012	From 1 July 2013	From 1 July 2014	From 1 July 2015 (final rate)
Biodiesel (including renewable diesel)	0*	3.8	7.6	11.4	15.3	<b>19.1</b>
<b>Other alternative fuels</b>						
LPG	nil	2.5	5.0	7.5	10.0	<b>12.5</b>
LNG	nil	2.5	5.0	7.5	10.0	<b>12.5</b>
CNG (in cents per cubic metre — m <sup>3</sup> **)	nil	3.8	7.6	11.4	15.3	<b>19.1</b>
Methanol	nil	1.7	3.4	5.1	6.8	<b>8.5</b>

Footnote: These rates are rounded to one decimal place.

\* Biodiesel that meets the fuel standard currently has an effective excise rate of zero due to the Energy Grants (Cleaner Fuels) Scheme grant, unlike the other fuels listed, which are currently outside the fuel taxation system.

\*\* Consistent with the policy announced in 2003-04, it is proposed that CNG will be taxed at 19.1 cents per cubic metre. See discussion questions on CNG in relation to the appropriate measurement unit.

## 4. THE 2010-11 BUDGET AND LATER ANNOUNCEMENTS

12. The Government announced in the 2010-11 Budget that the longstanding plan announced by the then Government in the 2003-04 Budget for the taxation of alternative fuels would be implemented.
13. The Government recognises that alternative fuels have the potential to reduce environmental harm as they have the capability to reduce Australia's carbon footprint. They provide an alternative to conventional fuels which ensures that there is a wider and more diverse range of energy sources; and the alternative fuel industries create jobs, particularly in rural and regional areas in Australia.
14. Accordingly, to ensure the domestic industry has time to adjust to the new arrangements, the Government announced on 13 May 2010 a new staged phasing in of the regime for domestic ethanol. The Government announced on 7 September 2010 that the phasing in arrangements for domestic ethanol were to be extended further to provide a more gradual transition path.
15. Therefore, domestic ethanol producers will receive targeted assistance over a ten year period to manage the phase in of the new arrangements. Imported ethanol will experience a phase down in excise-equivalent customs duty over a five year transition period.
  - (a) This will involve setting the fuel tax rate for domestic and imported ethanol at its full energy content rate, 25 cents per litre, from 1 July 2011, falling in equal proportions each year to 50 per cent of its energy content rate, 12.5 cents per litre, on 1 July 2015.
  - (b) The fuel tax rate for domestically produced ethanol will be set at the same rate as the rate applying to imported ethanol from 1 July 2011. As set out in Table 2 below, a production grant for domestically produced ethanol will gradually phase out until no grant is payable from 1 July 2020, resulting in the same arrangements applying to both domestically produced and imported ethanol from that date.

**Table 2: The transition path for ethanol (in cents per litre)**

Rate and grant	From 1 July 2010	From 1 July 2011	From 1 July 2012	From 1 July 2013	From 1 July 2014	From 1 July 2015	From 1 July 2016	From 1 July 2017	From 1 July 2018	From 1 July 2019	From 1 July 2020
<b>Legislated rate for ethanol *</b>											
Legislated rate	38.143	25	21.9	18.8	15.6	12.5	12.5	12.5	12.5	12.5	<b>12.5</b>
<b>Domestic ethanol – production grant</b>											
Production Grant for Ethanol	38.143	23.75	19.4	15.05	10.6	6.25	5	3.75	2.5	1.25	<b>0</b>
<b>Domestic ethanol – legislative rate less grant</b>											
Legislated rate less grant	0	1.25	2.5	3.75	5	6.25	7.5	8.75	10	11.25	<b>12.5</b>

Footnote: The rates have been rounded.

\* This is the final rate that applies to imported ethanol

## 5. PHASING IN EXCISE FOR GASEOUS FUELS AND BIODIESEL

16. The 2003-04 policy announcement contemplates that legislation would set the final 1 July 2015 fuel tax rate for gaseous fuels and biodiesel, but the effective fuel tax rate would be established by extending the operation of the Energy Grants (Cleaner Fuels) Scheme to alternative fuels.
  - (a) Grants would be phased down by 20 per cent each year, until they were phased out as at 1 July 2015. Under this mechanism, the liable entity would pay the full fuel tax rate (for example, biodiesel would pay 19.1 cents per litre) and then eligible entities would claim back a partial grant under the Energy Grants (Cleaner Fuels) Scheme.
  - (b) For example, if the full fuel tax rate applicable to biodiesel was 19.1 cents per litre, but the effective fuel tax rate was 3.8 cents per litre, 15.3 cents per litre could be claimed under the Energy Grants (Cleaner Fuels) Scheme.
17. However, the entity claiming the grant under the Energy Grants (Cleaner Fuels) Scheme will not necessarily be the same entity paying the fuel tax. In addition, eligibility for the Energy Grants (Cleaner Fuels) Scheme grants requires substantiation that the Fuel Quality Standards have been complied with.
18. One approach that could streamline the administrative arrangements is to set the effective rate of fuel tax directly under the relevant excise and customs legislation without any grant entitlement. Setting the fuel tax rates in this way may be an efficient mechanism for phasing in taxation and reducing business compliance costs as industry will only be required to comply with one system of payment, rather than a payment and subsequent grant claim system.
19. Therefore, the increase in the fuel tax rates for the gaseous fuels and biodiesel could be set out in legislation for each year (without grants) until the final rate is reached on 1 July 2015.
20. Under this approach, at each stage of the transition period, the legislated fuel tax rate for biodiesel, the gaseous fuels and methanol would be the effective fuel tax rate. No grants would be required.
  - (a) For example, manufacturers and importers of biodiesel would pay fuel tax of 3.8 cents per litre from 1 July 2011, 7.6 cents per litre from 1 July 2012, 11.4 cents per litre from 1 July 2013, 15.3 cents per litre from 1 July 2014, until 1 July 2015 when the final rate of 19.1 cents per litre is reached (see Table 1).
21. If this option was implemented it would be possible to repeal the *Energy Grants (Cleaner Fuels) Scheme Act 2004* to ensure that grants payable for periods after 30 June 2011 cease.
22. Irrespective of the approach taken to impose effective excise on the gaseous fuels and biodiesel, it will be necessary to make some changes to the transitional arrangements applying from 1 July 2011 for the phase down of the grant available for all alternative fuels. This phase down would reduce the grant rate by 20 per cent per year from 1 July 2011 until it would be removed completely from 1 July 2015. However, the existing arrangements do not include the 50 per cent discount for alternative fuels.

## Questions

- (i) Would there be any additional compliance costs from imposing the fuel tax rate directly in the excise and customs legislation rather than also applying a grant for the gaseous fuels and biodiesel each year during the transition period?
- (ii) Are there any adverse or other unintended consequences of repealing the operation of the Energy Grants (Cleaner Fuels) Scheme from 1 July 2011, provided entitlements arising prior to 1 July 2011 can still be claimed?

## 6. REVISED TAXATION AND GRANT ARRANGEMENTS FOR ETHANOL

### 6.1 DOMESTIC ETHANOL ASSISTANCE

23. The Government announced in the 2010-11 Budget that targeted assistance would be made available to domestic ethanol producers, and phased down over the transition period. In addition, imported ethanol would also experience a more gradual reduction in excise-equivalent customs duty over the transition period than previously announced. Subsequently, the Government announced on 7 September 2010 that there will be a more gradual phase down of the transitional arrangements for domestically produced ethanol.
24. Domestic producers of ethanol produced entirely in Australia from biomass feedstock which is to be used in, or as, transport fuel in Australia will be eligible for the targeted assistance.
25. The Government is committed to developing the most effective mechanism for delivering that assistance. In the joint press release of 13 May 2010, the Government committed to removing the Energy Grants (Cleaner Fuels) Scheme for ethanol and to use direct assistance instead.
26. The Ethanol Production Grant Program is currently administered by AusIndustry (on behalf of the Department of Resources, Energy and Tourism). It comprises contractual agreements between ethanol producers and the Government, and eligibility is as set out in paragraph 24 above.
  - (a) The Program's objective is to encourage the use of biofuels in transport in Australia. The program commenced on 18 September 2002 and it is available to ethanol producers until 30 June 2011. Ethanol Production Grants are currently paid to ethanol (fuel) producers at a rate of 38.143 cents per litre.
27. It is proposed that a production grant be provided until 30 June 2020, with grants phased down over the transition period and with these grants administered by the Australian Taxation Office. It may also be possible to make changes to the delivery of the grant program to improve the efficiency of the program.

### 6.2 TAXATION OF ETHANOL

28. It is proposed that the rate of excise that applies to domestically produced ethanol be aligned with the rate of excise-equivalent customs duty that applies to imported ethanol from 1 July 2011. The production grant would then apply to domestically produced ethanol during its ten year transition period (see Table 2).

## Principle — Fuel tax to apply to ethanol used in internal combustion engines

Continue to impose fuel excise and excise-equivalent customs duty on ethanol at the point of production and importation.

The rate of excise applying to domestically produced ethanol will be consistent with the rate of excise-equivalent customs duty that applies to imported ethanol.

### Commentary

29. This will require the rate of fuel excise for denatured ethanol for use in an internal combustion engine in the Schedule to the *Excise Tariff Act 1921* and the *Customs Tariff Act 1995* to be reduced over the transition period. Domestic and imported ethanol will have a common transitional tax rate (see Table 2 above).
30. However, assistance would be provided to producers of domestic ethanol by phasing down the proposed production grant over a ten year transitional period (see Table 2 above). Accordingly, no production grant would apply to domestic ethanol from 1 July 2020, resulting in the same arrangements applying to domestic and imported ethanol from this time.
31. An amendment will also be required to section 6G of the *Excise Tariff Act 1921*. This is needed because the rate of excise or excise-equivalent customs duty applying at the time of production or importation during the transition period may be different from the rate of tax that applies at the time of blending as the rate changes on 1 July each year over the transition period.
32. The ad valorem duties of customs of up to 5 per cent, depending on origin, will continue to apply.

### Questions

- (iii) Are there any impediments for the domestic ethanol industry in providing a production grant program for domestic ethanol producers beyond 2011?
- (iv) Should the proposed production grant program be administered by the Australian Taxation Office or should it be administered by AusIndustry or another agency?
- (v) Are there any improvements to the administration of the proposed production grant program that could be made that would be consistent with the Government's ethanol policy and improve the grant's effectiveness or reduce compliance costs for industry?
- (vi) Are the proposed arrangements broad enough to include ethanol produced from all emerging feedstocks under new or emerging technologies?

## 7. TAXATION OF GASEOUS FUELS

33. The current system for the taxation of fuels in general imposes a fuel tax liability and a remittance obligation on fuel manufacturers and importers. The fuel tax credit scheme provides credits to remove or reduce the incidence of fuel tax for business use, other than use in light vehicles on-road.
34. Gaseous fuels are used for many additional purposes other than fuel use in an internal combustion engine, for example in industrial applications and for heating and in burners used for cooking.
35. The key objectives in implementing the taxation arrangements for gaseous fuels are that:
  - (a) compliance costs are minimised by ensuring that fuel tax is imposed on the least number of parties as possible, consistent with the objective of taxing the transport use of fuel;
  - (b) fuel tax is imposed under a framework that can be administered effectively and ensures that tax can be collected where it is due; and
  - (c) the impacts of the changes are minimised and apply in a streamlined way to affected parties, without unintended consequences.

### Principle — taxation of CNG

Excise on CNG is imposed on the manufacturer or importer of CNG for transport use, other than for export.

### Commentary

36. It is proposed that the point of manufacture for CNG will broadly follow the New Zealand approach which determines the point of manufacture under section 69 of the *New Zealand Customs and Excise Act 1996*. Under the legislation, manufacture of CNG is treated as having occurred when a licensee supplies natural gas to a CNG fuelling facility which is compressed for use as a motor vehicle fuel.
37. Taxing the transport use of CNG at its point of manufacture is proposed because intended use can be readily determined at this time as CNG is applied directly for transport applications after manufacture. There are currently a few public refuelling stations for CNG. However, we understand that there is the potential for home refuelling products which manufacture CNG.

### Questions

- (vii) To what extent is CNG manufactured by householders for transport use?
- (viii) Is there potential for household manufacture of CNG to increase?

## Principle — taxation of LNG

Excise is imposed on all domestic production of LNG, other than LNG for export. However, collection of excise only occurs where the LNG is supplied by distributors for transport use.

Importations are subject to excise-equivalent customs duty where intended for transport use.

### Commentary

38. Under this principle, although excise is imposed on domestic production, collection would not occur until the LNG is typically at the marketer or distributor point in the supply chain and the intended use of the product is known. Accordingly, tax would only be collected where the LNG is supplied directly for transport use or delivered into storage tanks that are connected to vehicle refuelling equipment.
39. Only importations of LNG that are intended for transport use would be subject to excise-equivalent customs duty.
40. Imposing excise at the point of production but deferring collection until the intended use of the LNG is known ensures that collection only occurs when transport use of the LNG is identified, typically at the distributor or marketer level in the supply chain.

### Questions

- (ix) Will the intended use of LNG be able to be readily determined by producers or importers of LNG?

## 7.1 IMPLEMENTATION

41. Several approaches could be adopted for the implementation of taxation on LPG used for transport applications. This could involve imposing excise at different points in the LPG supply chain. The different approaches have varying administrative and compliance cost impacts. Two options are outlined below and feedback is sought on these options.

### Option 1: Imposition on manufacturer — collection from marketer

Excise could be imposed on the manufacture of all LPG (other than for export) and excise-equivalent customs duty imposed on the importation of LPG.

However, no excise or excise-equivalent customs duty would apply to LPG supplied for household (non-vehicle) use.

Under this option, excise and excise-equivalent customs duty would apply to all LPG (other than for export or household use). Businesses would claim fuel tax credits for LPG acquired for qualifying transport and non-transport applications.

This option would be achieved by:

- Imposing excise on the manufacture of all LPG delivered from licensed premises with remission of any excise liability if LPG is delivered:
  - in containers of less than 50 kilograms; or
  - directly into a bulk tank connected to residential premises for the purposes of domestic cooking and heating.
- Imposing excise-equivalent customs duty on the importation of all LPG, other than importations in containers of less than 50 kilograms.

### Commentary — option 1

42. Option 1 involves imposing excise on the manufacture of all LPG but defers collection until the point in the supply chain when it is known that the LPG will not be supplied for household use. This is typically at the distributor or marketer level in the supply chain.
43. Accordingly, no excise would be collected where the end-use is clearly for household purposes. This would be achieved by providing a remission in the excise law setting out that no excise duty is payable when LPG is supplied in containers of less than 50 kilograms or when directly provided in a bulk tank connected to residential premises for the purposes of domestic cooking and heating.
44. Supplies to businesses would be subject to excise where the end use of LPG can be determined as not being for household purposes (see above). However, consistent with the *Fuel Tax Act 2006*, businesses may be eligible to claim fuel tax credits for both eligible transport and non-transport uses.

### Option 2: Imposing excise on distributors and marketers

Excise could apply to all LPG that is distributed or marketed for end use in transport applications, other than for export markets. Excise-equivalent rates of duty would also apply for imported LPG for transport applications. Household (non-transport) use would not be taxed.

This option could apply to all LPG for use in transport applications. Businesses would then claim fuel tax credits for LPG used for eligible transport purposes.

This option would be achieved by imposing excise liability on marketers or distributors of LPG that is delivered into storage that is attached to vehicle refuelling equipment.

### Commentary — option 2

45. Option 2 would result in the imposition and collection of excise at the point in the supply chain when end use is known. This is typically at the point of distribution or marketing of LPG.
46. Excise would be imposed and collected when the distributor or marketer sells fuel to a service station or a business that intends to use LPG for transport use. No fuel tax would be payable when the fuel is sold to a household or a business for a non-transport use. However, fuel tax

would be payable and also penalties would potentially apply if LPG was sold for non-transport use but later used for transport purposes.

## Key elements of options 1 and 2

**Table 3: Comparison of options for taxation of LPG**

Element	Option 1	Option 2
Point at which excise obligation applies	Manufacturer/importer	Marketer/distributor
Point at which excise collected	Marketer/distributor	Marketer/distributor
What is taxed	All use of LPG (except household use of LPG and exports)	Transport use of LPG (except household use of LPG and exports)
Uses subject to net excise after fuel tax credits	Private transport use and light vehicle use on-road by businesses*	Private transport use and light vehicle use on-road by businesses*

\* Some net excise will apply to on-road heavy vehicle use by businesses that are liable for the road user charge.

47. Although Options 1 and 2 impose effective excise on the same taxation base, the point of imposition is closer to the user of the LPG under Option 2. Option 1 imposes excise on a wider taxation base but uses the fuel tax credit system to ensure that effective excise applies to the same base.

### Questions

- (x) Which option for taxing LPG would be the most effective and have the overall lowest compliance cost impact on affected parties?
- (xi) What administrative collection trade-offs exist between the two LPG options?
- (xii) Do the proposed approaches to tax LPG ensure that *non-transport* fuels are not ultimately taxed?
- (xiii) Are marketers and distributors able to accurately identify the intended end use of LPG sold in bulk?
- (xiv) Is 50 kilograms an appropriate threshold to ensure that household use of LPG is not taxed?

## 7.2 MEASUREMENT OF GASEOUS FUELS

48. While LPG and LNG for transport use are usually measured in litres, CNG, which is a compressed gas, is usually measured by volume. It is proposed that CNG be taxed using cubic metres as the unit of measurement. This is consistent with the existing Energy Grants Credits Scheme, administered by the Australian Taxation Office.
49. However, this measurement unit is not always used in other countries. For example, New Zealand taxes natural gas (when compressed by a natural gas fuelling facility for use as a motor vehicle fuel) by gigajoule.

### Questions

- (xv) Are cubic metres the most appropriate unit of measurement for CNG or is an alternative measurement unit preferable?
- (xvi) Is the cents per litre unit of measurement the most appropriate for the other gaseous fuels?
- (xvii) What temperature and pressure standards should apply to the measurement of the alternative fuels?

## 8. TAXATION OF BIODIESEL AND RENEWABLE DIESEL

50. The current system for the taxation of biodiesel and renewable diesel imposes excise and excise-equivalent customs duty at the diesel excise rate with grants available under the Energy Grants (Cleaner Fuels) Scheme. Biodiesel and renewable diesel must meet the relevant fuel quality standard to qualify for the grant.

### Principle – taxing biodiesel

The existing taxation point for biodiesel and renewable diesel for both excise and excise-equivalent customs duty will be maintained.

### Commentary

51. It is proposed that the existing taxing point of biodiesel and renewable diesel will continue to apply for both manufacture and importation. The transitional arrangements for the imposition of excise on biodiesel and renewable diesel could be determined by directly setting the excise rate in the excise and customs legislation from 1 July 2011. Alternatively, they could be set by applying the final 1 July 2015 concessional rate of excise and excise-equivalent customs duty and paying a diminishing rate of grant calculated under the Energy Grants (Cleaner Fuels) Scheme, to effectively phase in the 2015 concessional rate.
52. Similarly to ethanol, an amendment would also be required to section 6G of the *Excise Tariff Act 1921* to allow the calculation of fuel tax for biodiesel and renewable diesel blends subject to different tax rates in the transition period (see discussion for ethanol at paragraph 31).

### Questions

- (xviii) Is the setting of the net excise rate for biodiesel and renewable diesel in the excise and customs legislation the most effective approach to minimise industry compliance costs?
- (xix) Alternatively, should the rate of excise applicable be set at the final 1 July 2015 rate in the excise and customs legislation and the net excise rate be established by applying a grant calculated under the Energy Grants (Cleaner Fuels) Scheme?
- (xx) Would a separate administrative grant for biodiesel and renewable diesel be the most effective way to impose excise and excise equivalent customs duty on biodiesel and renewable diesel from 1 July 2011 (recognising the potential for technological developments to result in a wide range of feedstocks being used in the future)?

## 9. OTHER ISSUES

### 9.1 TRANSPORT APPLICATIONS

53. Biodiesel, renewable diesel and ethanol are already subject to excise, but producers, and in some cases importers, can obtain a grant. It is now intended to impose excise on gaseous fuels and methanol that are used in transport applications in internal combustion engines.
54. Transport use will include fuel used in motor vehicles and transport equipment that uses an internal combustion engine, such as forklifts, boats, and other equipment in which the engine functions to transport people or loads beyond a fixed base.

#### Question

- (xxi) Are there any transport applications that may be powered by alternative fuels that do not use an internal combustion engine?

### 9.2 TAXATION OF METHANOL

55. Methanol has not previously been subject to excise or excise-equivalent customs duty. There is evidence to suggest that methanol is not widely used as a transport fuel either directly, in blends, or as a fuel substitute. Under Australian Fuel Quality Standards, methanol cannot be used as an extender or additive to petrol or diesel for commercial sale. This is due, in part, to the significant damage that methanol can cause to engines designed to run on petrol or diesel. Methanol is mostly used as an industrial chemical.
56. However, methanol is currently used as a fuel in some motor racing applications and accordingly a taxing mechanism is necessary to apply to this form of transport use.

#### Principle – taxing of methanol

- (xxii) Excise and excise-equivalent customs duty will apply to all methanol that is distributed or marketed for transport purposes.

#### Commentary

57. It is proposed that the taxation point for methanol will be the marketer or distributor when the methanol is packaged and marketed for a transport use as this is the point at which the end-use of the fuel is able to be determined. This approach is broadly similar to Option 2 proposed for the taxation of LPG.

### Questions

- (xxiii) To what extent is methanol used in motor racing or in other applications as a transport fuel?
- (xxiv) Is this likely to change in the future?
- (xxv) Will the proposed taxation point for methanol ensure that fuel tax can be imposed on methanol effectively, whilst minimising compliance costs?

## 9.3 TAXING ACT TO IMPOSE FUEL TAX

- 58. The *Excise Tariff Act 1921* and the *Customs Tariff Act 1995* currently impose excise and excise-equivalent customs duty on a range of transport fuels, including petrol, diesel, renewable diesel, biodiesel and ethanol. However, grants are payable for renewable diesel, biodiesel and domestically produced ethanol. In order to minimise impacts and provide consistent taxing arrangements for the taxation of all alternative fuels, it is intended that the taxation of the gaseous fuels and methanol also be implemented in the *Excise Tariff Act 1921* and the *Customs Tariff Act 1995*.
- 59. A number of LPG, LNG and CNG producers are likely to have existing excise obligations and therefore the taxing of gaseous fuels in the excise legislation may minimise their compliance costs.

### Questions

- (xxvi) How many businesses are likely to have new excise obligations as a result of the proposals?

## 9.4 TRANSITIONAL ARRANGEMENTS

- 60. There are a number of transitional matters to be dealt with in bringing alternative fuels into the excise and excise-equivalent customs duty regime. These include ensuring that goods manufactured or imported prior to 1 July 2011 are not subject to effective excise or excise-equivalent customs duty and that sufficient time is available for manufacturers/distributors and marketers to be licensed.

### Questions

- (xxvii) What transitional arrangements will be needed to ensure that production or importation of the alternative fuels prior to 1 July 2011 is not subject to effective excise or excise-equivalent customs duty?
- (xxviii) Are special arrangements required to allow affected parties sufficient time to become licensed after the start of taxation arrangements on 1 July 2011?

## APPENDIX A: ENTITLEMENTS TO FUEL TAX CREDITS FOR ALTERNATIVE FUELS

### INTRODUCTION TO FUEL TAX CREDITS

61. The *Fuel Tax Act 2006* introduced fuel tax credits. Eligibility for fuel tax credits depends upon the vehicle used and/or the activity undertaken. In general, full fuel tax credits are payable for business activities for agriculture, fishing, forestry, mining, marine transport, rail transport, nursing and medical, and electricity generation and for non-fuel use (that is, other than in an internal combustion engine).
62. Generally, other off-road business activities are eligible for a partial fuel tax credit equal to 50 per cent of the fuel tax less any grant payable on the fuel. This is scheduled to increase to a full fuel tax credit from 1 July 2012. Other off-road business activities encompass a wide range of activities, including construction, manufacturing, wholesale/retail, property management and landscaping.
63. Heavy on-road transport (vehicles with a gross vehicle mass of more than 4.5 tonnes) is eligible for a fuel tax credit less the non-hypothecated road user charge. The road user charge is 22.6 cents per litre as at 1 July 2010. The road user charge, together with vehicle registration fees, reflects the damage caused to roads by heavy vehicles and is adjusted each year according to a determination by the Minister that administers the *Motor Vehicle Standards Act 1989*.
64. The fuel tax credit system requires that fuel tax credits cannot exceed the fuel tax (excise or excise-equivalent customs duty) paid, less any grants or subsidies on that fuel (except in the case of standard fuel blends).
65. Fuel tax credits can be claimed for petrol blends and diesel blends which meet the petrol or diesel fuel standard under the *Fuel Quality Standards Act 2000*. Blends which meet this standard are given a credit as if the blend wholly consisted of petrol or diesel; that is they obtain a full fuel tax credit. For example, E10, which is a blend of 10 per cent ethanol and 90 per cent petrol, meets the petrol standard and receives a full fuel tax credit. Additionally, B5 which is a blend of 5 per cent biodiesel and 95 per cent diesel, meets the diesel standard and receives a full fuel tax credit.

## Fuel standards

The *Fuel Quality Standards Act 2000* and the *Fuel Quality Standards Regulations 2001* provide the framework for enforcing national fuel quality standards. The legislation regulates the quality of fuel supplied in Australia and ensures that, where appropriate, information about fuel is provided when the fuel is supplied.

The standards for petrol and diesel are prescribed in the *Fuel Standard (Petrol) Determination 2001* and the *Fuel Standard (Diesel) Determination 2001*. Fuel quality standards have been set for petrol, diesel, biodiesel and LPG. Ethanol (in petrol) has a fuel quality information standard and a fuel quality standard (as part of the determination for petrol).

## HOW FUEL TAX CREDITS WILL OPERATE FOR ALTERNATIVE FUELS

66. From 1 July 2011, business users of ethanol, methanol, biodiesel and the gaseous fuels will become eligible for fuel tax credits where the fuel is used off-road. As the road user charge for on-road vehicles exceeds the rate of excise on alternative fuels, no fuel tax credits will be payable for on-road use of alternative fuels in heavy vehicles.

## Ethanol and biodiesel

67. The most common uses of ethanol and biodiesel are as components of blends with petrol and diesel that meet the petrol and diesel standards respectively. For businesses that use petrol, diesel, E10 and B5, there will be no change to their fuel tax credit entitlement.
68. For fuel blends that do not meet the standard (for example, if there was a blend of 30 per cent biodiesel and 70 per cent diesel) fuel tax credit entitlements will be on a pro rata basis and businesses will be required to apportion the fuel tax on the biodiesel and the diesel to determine their fuel tax credit entitlement.

## Example

Agricultural business activities are eligible for fuel tax credits. If Bob uses a diesel-powered tractor to cart materials around his vineyard, the fuel he uses for this activity is currently eligible for fuel tax credits at the rate of 38.143 cents per litre.

If Bob uses a biodiesel blend to power his tractor in the course of his business, he can currently claim a full fuel tax credit at a rate of 38.143 cents per litre for the entire blend if the blend meets the diesel fuel standard. After 1 July 2011, if Bob uses a tractor powered by a biodiesel blend such as B5, then Bob will still be eligible for a full fuel tax credit at a rate of 38.143 cents per litre for the entire blend (as blends such as B5 meet the diesel fuel standard).

69. Where blends of fuel containing ethanol in excess of the E10 standard are used by businesses for purposes that qualify for fuel tax credits, businesses must claim fuel tax credits on the excise rate less any grant that applies to each fuel contained in the blend. Although no importations of ethanol are currently made, as the tax rate less the grant payable converges

between domestically produced and imported ethanol during the transition period, importations may occur. Accordingly, as businesses are unlikely to know whether the ethanol they purchase has a domestic or imported origin, a standardised treatment for fuel tax credits for ethanol (regardless of imported or domestic origin) could reduce uncertainty and minimise compliance costs during the transition period.

70. The standardised treatment could involve ensuring that the rate of tax for domestic ethanol less the production grant payable is taken to apply in working out the fuel tax credit entitlement for all ethanol, regardless of its source. This could streamline the fuel tax credit entitlement process and reduce business compliance costs. An amendment to the *Fuel Tax Act 2006* would be required to give effect to this.

### Questions

- (xxix) Is a standardised approach to claiming fuel tax credits likely to reduce compliance costs for ethanol blends above E10?

### On-road and off-road treatment (gaseous fuels, biodiesel and ethanol)

71. The taxing of certain compressed and liquefied gaseous fuels will result in them becoming 'taxable fuels' for fuel tax credit purposes. Accordingly, off-road business users of alternative fuels in transport applications will be eligible for fuel tax credits.
72. Gaseous fuels, ethanol, methanol and biodiesel (in a blend or otherwise that does not meet the petrol or diesel standard) used by a business off-road will be eligible for fuel tax credits.
73. Gaseous fuels, ethanol, methanol and biodiesel (in a blend or otherwise that does not meet the petrol or diesel standard) used by a business in a heavy vehicle (greater than 4.5 tonnes) on-road will also become eligible for fuel tax credits. However, the amount of the fuel tax credit available will be limited to the excise payable less any applicable grant on that fuel.
74. By becoming eligible for fuel tax credits, businesses that use these fuels in heavy vehicles on-road in the course of their business also become liable for the road user charge that is currently paid by heavy vehicles using petrol and diesel. The 2006 changes to the fuel tax system outlined that the road user charge would apply to the alternative fuels as well as diesel and petrol.
75. Consequently, when the road user charge is less than the excise payable less any applicable grant, businesses will be entitled to claim the difference as a fuel tax credit. However, when the road user charge is higher, businesses will not be required to pay the road user charge and instead their fuel tax credit entitlement will be zero.

### Example

Jane drives her delivery truck to deliver goods for her business. After 1 July 2011, if Jane uses LNG on which 2.5 cents per litre excise has been levied, as the amount of the road user charge exceeds the amount of fuel excise paid, Jane's fuel tax credit entitlement will be zero.

## APPENDIX B: WHAT WILL OCCUR IF NO ACTION IS TAKEN BY THE GOVERNMENT?

76. In the absence of further legislation to give effect to the 2003-04 Budget announcement, a number of consequences will automatically flow from 1 July 2011. Primarily, gaseous fuels will remain outside the excise system; there will be no energy-content based taxation for the alternative fuels; and there will be no 50 per cent discount for these fuels. This would be inconsistent with the Government's policy on the taxation of alternative fuels. In addition to this, there will be further consequences.
- (a) Ethanol and biodiesel will continue to be taxed at the petrol and diesel excise rate of 38.143 cents per litre. However, from 1 July 2011, the Energy Grants (Cleaner Fuels) Scheme grants will start phasing down by 20 per cent per year. From 1 July 2011 to 1 July 2012, alternative fuel producers and importers will be entitled to a grant of 80 per cent of whatever the relevant fuel excise rate is at the time.
  - (b) Contracts made under the Ethanol Production Grant Program will cease on 30 June 2011. Ethanol producers and importers will become subject to the Energy Grants (Cleaner Fuels) Scheme grants.
  - (c) While gaseous fuels will also become eligible for Energy Grants (Cleaner Fuels) Scheme grants, legislation to impose excise and excise-equivalent customs duty on the gaseous fuels is not yet in place. Gaseous fuels are entitled to receive a grant that is equivalent to a percentage of the relevant excise rate. As this rate is zero, gaseous fuels would not be entitled to receive a grant.
77. Accordingly, without further legislation, from 1 July 2011, biodiesel and domestically produced ethanol will be progressively taxed at a higher rate than proposed in the changes announced in the 2010-11 Budget with equal annual increases until reaching parity with the existing excise rate for petrol and diesel on 1 July 2015. Imported ethanol will also be taxed at the same rate as domestic ethanol from 1 July 2011.

## GLOSSARY

Term	Description
alternative fuels	For the purposes of this paper alternative fuels includes the biofuels, ethanol, biodiesel and renewable diesel and the gaseous fuels, LPG, LNG and CNG.
AusIndustry	Ausindustry administers the Ethanol Production Grant Program.
Australian Fuel Quality Standards	The quality of fuel in Australia is regulated by the <i>Fuel Quality Standards Act 2000</i> . Fuel quality standards have been made for petrol, diesel, biodiesel and autogas.
autogas	LPG utilised in motor vehicles.
B5	A blend of 5 per cent biodiesel and 95 per cent diesel.
biodiesel	Mono-alkyl esters of fatty acids of a kind used as a fuel, derived from animal or vegetable fats and oils.
biomass feedstock	The organic materials used in the production of biofuels.
blend	Means to combine fuel with another kind of fuel or any other substance.
CNG	Compressed natural gas.
E10	A blend of 10 per cent ethanol and 90 per cent petrol.
Energy Grants (Cleaner Fuels) Scheme	The Energy Grants (Cleaner Fuels) Scheme is administered by the Australian Taxation Office.
energy-content based taxation	For the purposes of this paper, the rate of fuel tax is based on the energy content of the fuel.
ethanol	Fuel ethanol is made from natural renewable sources and can be blended with petroleum based unleaded fuels. It is a clear, colourless hydrocarbon and can be produced from fermenting sugars from carbohydrates in agricultural crops and cellulosic residues from crops or wood.
Ethanol Production Grant Program	The Ethanol Production Grant Program is administered by AusIndustry.
excise	Excise duty.

Term	Description
excise duty	Excise duty is a tax on certain types of goods produced or manufactured in Australia. These excisable goods include alcohol, tobacco and petroleum and some alternative fuels.
excise-equivalent customs duty	Excise duty is paid on locally manufactured goods, whereas excise-equivalent customs duty is paid on equivalent imported goods. Customs duty is imposed at an equivalent rate on imported alcohol, tobacco and petroleum to ensure that imported goods are treated consistently with local goods. These goods are referred to as excise-equivalent goods.
fuel additive	A substance that is generally sold or represented as suitable for adding to fuel to affect the properties of the fuel, including the effect of the additive on engine performance, engine emissions or fuel economy.
fuel distributor	A person who supplies fuel between an import terminal, a refinery, a blending facility or a retail fuel outlet.
fuel ethanol	Fuel ethanol is ethanol which has been denatured (chemically treated to make it unfit for human consumption, usually by the addition of 1 per cent — 5 per cent petrol) for use in an internal combustion engine.
fuel tax credit	An entitlement arising under section 41-5, 41-10 or 42-5 of the <i>Fuel Tax Act 2006</i> .
gaseous fuels	For the purposes of this paper gaseous fuels are LPG, LNG and CNG.
gigajoule	A gigajoule is equal to one billion joules. Joules are the primary measure of energy in the metric system.
GST	Goods and Services Tax.
GVM	Gross vehicle mass.
heavy on-road transport	Vehicles with a gross vehicle mass of more than 4.5 tonnes.
LNG	Liquefied natural gas.
LPG	Liquefied petroleum gas.
methanol	A light, volatile alcohol.
renewable diesel	Liquid fuel manufactured by chemically altering vegetable or animal fats and oils by a process of hydrogenation.
road user charge	The road user charge is part of the heavy vehicle charging regime and recovers a portion of the road construction and maintenance costs attributable to heavy vehicles.