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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION OF ALTERNATIVE FUELS LEGISLATION AMENDMENT
BILL 2011
EXCISE TARIFF AMENDMENT (TAXATION OF ALTERNATIVE FUELS)
BILL 2011
CUSTOMS TARIFF AMENDMENT (TAXATION OF ALTERNATIVE FUELS)
BILL 2011
ENERGY GRANTS (CLEANER FUELS) SCHEME AMENDMENT BILL 2011

EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP and the Minister for
Home Affairs, the Hon Brendan O'Connor MP)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
ASEAN	Association of Southeast Asian Nations
B20	a blend of up to 20 per cent biodiesel and 80 per cent or more diesel
B5	a blend of up to 5 per cent biodiesel and 95 per cent or more diesel
CNG	compressed natural gas
cpl	cents per litre
E10	a blend of up to 10 per cent ethanol and 90 per cent or more petrol
E85	a blend of up to 85 per cent ethanol and 15 per cent or more petrol
Harmonized System	Harmonized Commodity Description and Coding System
LNG	liquefied natural gas
LPG	liquefied petroleum gas
NSW	New South Wales
TAA 1953	<i>Taxation Administration Act 1953</i>

General outline and financial impact

Taxation of alternative fuels

The four Bills contained in the package are the Taxation of Alternative Fuels Legislation Amendment Bill 2011, the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011, the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011 and the Energy Grants (Cleaner Fuels) Scheme Amendment Bill 2011.

These Bills bring certain alternative fuels used for transport purposes into the fuel taxation regime and make them subject to excise duty or excise-equivalent customs duty. The fuels affected are liquefied petroleum gas (LPG), liquefied natural gas (LNG) and compressed natural gas (CNG). The rates for these fuels are based on the energy content of the specific fuels and discounted by 50 per cent to reflect the potential benefits of these alternative fuels. The changes are phased in over a transition period to allow affected parties time to adjust to the changes.

The Taxation of Alternative Fuels Legislation Amendment Bill 2011 amends the *Excise Act 1901*, the *Fuel Tax Act 2006*, the *Product Grants and Benefits Administration Act 2000* and the *Taxation Administration Act 1953*. The Bill deals with the taxation of LPG, LNG and CNG in particular, establishes LPG reporting requirements, fuel tax credit entitlements and penalties concerning unauthorised excise-free LPG sale or use. The Bill also sets out transitional excise licensing requirements for the gaseous fuels (LPG, LNG and CNG).

The Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011 amends the *Excise Tariff Act 1921* to set the excise rates applying to certain alternative fuels from 1 December 2011, and to calculate the duty payable on blended goods.

The Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011 amends the *Customs Tariff Act 1995* to set the excise-equivalent customs duty rates applying to certain alternative fuels from 1 December 2011.

The Energy Grants (Cleaner Fuels) Scheme Amendment Bill 2011 extends the operation of the existing provisions of the *Energy Grants (Cleaner Fuels) Scheme Act 2004*.

Date of effect: These amendments apply, in general, to fuel acquired, manufactured or imported on or after 1 December 2011. The extension of

the current operation of the *Energy Grants (Cleaner Fuels) Scheme Act 2004* applies from 1 July 2011, with further changes applying to it from 1 December 2011.

This measure includes four Bills. As each Bill is part of the package, if any Bill does not receive Royal Assent, none of the Bills commence operation.

Proposal announced: The implementation by the Government of the longstanding policy to tax alternative fuels was announced in the then Assistant Treasurer and the Minister for Resources and Energy's joint Media Release No. 099 of 13 May 2010. The date of effect of the new tax changes was extended from 1 July 2011 to 1 December 2011 and announced in the Assistant Treasurer and Minister for Financial Services and Superannuation's Media Release No. 017 of 24 January 2011. The Government announced on 12 May 2011 that there will be a 10-year moratorium on changes to the taxation and grant arrangements for ethanol, biodiesel, renewable diesel and methanol. After the 10-year period, there will be a review of the arrangements.

Financial impact: This measure is estimated to have a gain to Budget revenue over the forward estimates period of \$518.5 million comprising:

<i>2011-12</i>	<i>2012-13</i>	<i>2013-14</i>	<i>2014-15</i>
\$16.5m	\$102m	\$166m	\$234m

Compliance cost impact: The introduction of taxation of LPG, LNG and CNG will result in some compliance costs.

Summary of regulation impact statement

Regulation impact on business

Impact: The Bills improve the operation of the fuel market by enhancing market efficiency and economic choice and providing certainty for industry.

Main points:

- Taxing the alternative fuels improves the operation of the fuel market by enhancing competition between the different types of fuels, improving market efficiency, economic choice and the consequent allocation of resources.

- Although the taxation based advantage of alternative fuels will be reduced, the tax changes continue to provide support to the alternative fuels industry in recognition of the potential environmental, fuel security and regional benefits that these industries can generate.
- The changes deliver certainty for business so that industry is able to make decisions confident in the knowledge of the tax arrangements that apply.

Chapter 1

Taxation of alternative fuels

Outline of chapter

1.1 The four Bills contained in the package are the Taxation of Alternative Fuels Legislation Amendment Bill 2011, the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011, the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011 and the Energy Grants (Cleaner Fuels) Scheme Amendment Bill 2011.

1.2 The Bills amend the *Excise Act 1901*, the *Excise Tariff Act 1921*, the *Customs Tariff Act 1995*, the *Fuel Tax Act 2006*, the *Product Grants and Benefits Administration Act 2000* and the *Taxation Administration Act 1953* (TAA 1953). The Bills extend then revise the operation of the *Energy Grants (Cleaner Fuels) Scheme Act 2004*. The Bills include certain alternative fuels used for transport purposes in the fuel taxation regime, and make them subject to excise duty or excise-equivalent customs duty. The taxation rates are based on the energy content of various fuels, and discounted to reflect the potential benefits of alternative fuels. The changes are phased in over a transition period to allow affected parties time to adjust to the changes.

Context of amendments

1.3 The Bills implement the longstanding plan for energy content based taxation of alternative fuels, with some amendments.

1.4 Under the current law the general rate of fuel tax of 38.143 cents per litre (cpl) which applies to petrol and diesel also applies to biodiesel, renewable diesel and ethanol, but not to liquefied petroleum gas (LPG), liquefied natural gas (LNG), compressed natural gas (CNG) or methanol.

1.5 There is currently a grant payable for biodiesel and renewable diesel of 38.143 cpl under the Energy Grants (Cleaner Fuels) Scheme where it meets the relevant fuel quality standards in the *Fuel Quality Standards Act 2000*.

1.6 In the case of ethanol, there may be an entitlement to a grant for eligible manufacturers under the existing Ethanol Production Grants Program.

- 1.7 The intention of the changes is to:
- introduce greater consistency in the taxation of fuels used for transport purposes and to ensure that competition between untaxed transport fuels and currently taxed fuels does not harm economic efficiency and create distortions;
 - provide certainty to industry; and
 - 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.

Summary of new law

- 1.8 The Bills include alternative fuels in the fuel taxation regime. These fuels include LPG, LNG and CNG.
- 1.9 The rates of excise and excise-equivalent customs duty are based on the energy content of the fuels with a 50 per cent discount. The alternative fuels excise rates are discounted to reflect the potential benefits of these fuels.
- 1.10 The amendments apply to fuel manufactured on or after 1 December 2011. The amendments also apply in the case of fuel imported into Australia before 1 December 2011 where the time for working out the rate of import duty on the goods had not occurred before 1 December 2011. The amendments also apply to fuel on hand at manufacturers' premises on 1 December 2011.
- 1.11 The amendments are phased in over a transition period to allow affected parties time to adjust to the changes.

Comparison of key features of new and current law

<i>New law</i>	<i>Current law</i>
LPG	
LPG for transport use is subject to fuel tax at the rate of 12.5 cpl. The application of tax is phased in over the period 1 December 2011 to 1 July 2015.	LPG is not subject to fuel tax.
LNG	
LNG for transport use is subject to fuel tax at a rate of 26.13 cents per kilogram. The application of tax is phased in over the period 1 December 2011 to 1 July 2015.	LNG is not subject to fuel tax.
CNG	
CNG for transport use (other than home manufacture for transport use and manufacture for forklift use) is subject to fuel tax at a rate of 26.13 cents per kilogram. The application of tax is phased in over the period 1 December 2011 to 1 July 2015.	CNG is not subject to fuel tax.
Biodiesel	
The <i>Energy Grants (Cleaner Fuels) Scheme Act 2004</i> is extended to continue the grant arrangements for biodiesel. Excise or excise-equivalent customs duty for biodiesel continues to be imposed at the point of manufacture or importation.	Fuel tax on biodiesel is imposed at the rate of 38.143 cpl, which also applies to petrol and diesel. Biodiesel producers and importers are eligible for a grant of 38.143 cpl paid under the <i>Energy Grants (Cleaner Fuels) Scheme Act 2004</i> where the biodiesel meets the relevant fuel quality standard under the <i>Fuel Quality Standards Act 2000</i> .

Taxation of Alternative Fuels Legislation Amendment Bill 2011
Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011
Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011
Energy Grants (Cleaner Fuels) Scheme Amendment Bill 2011

<i>New law</i>	<i>Current law</i>
Renewable diesel	
The <i>Energy Grants (Cleaner Fuels) Scheme Act 2004</i> is extended to continue the grant arrangements for renewable diesel. Excise or excise-equivalent customs duty for renewable diesel continues to be imposed at the point of manufacture or importation.	<p>Fuel tax on renewable diesel is imposed at the full rate of 38.143 cpl, which also applies to petrol and diesel.</p> <p>Renewable diesel producers and importers are eligible for a grant of 38.143 cpl paid under the <i>Energy Grants (Cleaner Fuels) Scheme Act 2004</i> where the renewable diesel meets the relevant fuel quality standard for diesel under the <i>Fuel Quality Standards Act 2000</i>.</p>
Ethanol	
<p>Domestically manufactured ethanol will continue to be subject to excise duty of 38.143 cpl.</p> <p>The existing contract based Ethanol Production Grants Program will be extended and the rate of the grant maintained.</p> <p>Excise-equivalent customs duty on ethanol will remain at 38.143 cpl.</p> <p>The legislated changes from 1 July 2011 to the <i>Energy Grants (Cleaner Fuels) Scheme Act 2004</i> will not apply to ethanol.</p>	<p>Fuel tax on ethanol is imposed at the full rate of 38.143 cpl, which also applies to petrol and diesel.</p> <p>Before 1 July 2011, qualifying ethanol producers are entitled to a grant of 38.143 cpl under the Ethanol Production Grants Program.</p> <p>From 1 July 2011 qualifying ethanol producers are eligible for a grant paid under the <i>Energy Grants (Cleaner Fuels) Scheme Act 2004</i> where the ethanol meets the relevant fuel quality standard under the <i>Fuel Quality Standards Act 2000</i>.</p>

<i>New law</i>	<i>Current law</i>
Fuel tax credits — end users	
An entitlement to fuel tax credits will apply to LPG, LNG and CNG used in carrying on an enterprise for off-road use. No net fuel tax credits will be payable where the fuel is used on-road in heavy vehicles as the road-user charge will exceed the rate of duty payable.	There is no entitlement to fuel tax credits for LPG, LNG or CNG as no fuel tax is payable.
Fuel tax credits — LPG unlicensed distributors	
Unlicensed distributors of LPG that acquire LPG that is subject to excise will be entitled to fuel tax credits to allow the sale of LPG to be effectively excise-free if: <ul style="list-style-type: none"> • supplied to businesses in tanks of 210 kilograms or less capacity for non-transport use; or • supplied to residential premises for non-transport use. 	No entitlement to fuel tax credits currently exists for distributors.

Detailed explanation of new law

1.12 The Bills implement energy content based taxation of certain transport fuels, with a 50 per cent discount for alternative fuels.

Ethanol

1.13 Ethanol is a liquid alcohol usually produced through fermentation and distillation from crops rich in sugar or starch. Australia currently produces ethanol from wheat, sorghum and C-grade molasses. There is potential for other feedstocks and technological processes to be used to produce ethanol in the future.

1.14 Ethanol as a fuel is most commonly sold as a blend of up to 10 per cent ethanol and 90 per cent or more petrol (E10) in Australia.

1.15 Currently, the petrol and diesel rate of fuel tax of 38.143 cpl applies to ethanol. A grant of 38.143 cpl is payable under the Ethanol Production Grants Program to qualifying ethanol manufacturers.

1.16 The existing Ethanol Production Grants Program operates on an administrative basis and is entered into contractually by producers. The program was to expire on 30 June 2011, and the *Energy Grants (Cleaner*

Fuels) Scheme Act 2004 was legislated to apply to the manufacture of ethanol from 1 July 2011.

1.17 Under these amendments excise and excise-equivalent customs duty continues to be imposed on ethanol at the point of manufacture or importation.

1.18 The Ethanol Production Grants Program will be extended. The rate of the grant will continue to be 38.143 cpl. The requirements of the contract based Ethanol Production Grants will continue, and qualifying manufacturers will need to comply with these requirements.

1.19 After 30 June 2021, the Government will conduct a review of the taxation arrangements for ethanol. The review is intended to encompass taxation of ethanol under the customs regime as well as the excise regime.

Biodiesel

1.20 Biodiesel is a fuel manufactured by chemically altering vegetable oils or animal fats or oils (or recycled oils from these sources). Biodiesel can also be produced from various non-food crops such as pongamia, jatropha curcas and algae.

1.21 Biodiesel is generally used as a transport fuel and sold as B5 or B20 (comprising diesel together with up to 5 per cent biodiesel or more than 5 per cent and up to 20 per cent biodiesel respectively). Biodiesel is chemically distinct from diesel.

1.22 The petrol and diesel rate of fuel tax of 38.143 cpl applies to biodiesel. Manufacturers and importers of biodiesel (provided they are the last licensed entity for the fuel) are eligible for a grant of 38.143 cpl paid under the *Energy Grants (Cleaner Fuels) Scheme Act 2004* where the biodiesel meets the relevant fuel quality standard under the *Fuel Quality Standards Act 2000*.

1.23 Excise and excise-equivalent customs duty is imposed on biodiesel at the point of manufacture or importation.

1.24 The *Energy Grants (Cleaner Fuels) Scheme Act 2004* is extended to provide an ongoing grant to eligible manufacturers or importers. However, after 10 years a review will be conducted of the taxation and grant arrangements. [*Schedule 1, items 1 and 2 of the Energy Grants (Cleaner Fuels) Scheme Amendment Bill 2011*]

1.25 After 30 June 2021, the Government will conduct a review of the taxation arrangements for biodiesel. The review is intended to encompass taxation of biodiesel under the customs regime as well as the excise regime.

1.26 The amendments also update the rules for working out the amount of fuel tax payable on blended goods such as blends of biodiesel and diesel. *[Schedule 1, item 2 of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

Renewable diesel

1.27 Renewable diesel is produced by a chemical process which results in the product having the same chemical structure as diesel. Renewable diesel producers and importers are currently eligible for a grant of 38.143 cpl paid under the *Energy Grants (Cleaner Fuels) Scheme Act 2004* for renewable diesel which meets the relevant fuel quality standard for diesel under the *Fuel Quality Standards Act 2000*.

1.28 Excise and excise-equivalent customs duty is imposed on renewable diesel at the point of manufacture or importation at a rate of 38.143 cpl. This reflects the high energy content of renewable diesel. After 30 June 2021, the Government will conduct a review of the taxation arrangements for renewable diesel.

1.29 The *Energy Grants (Cleaner Fuels) Scheme Act 2004* is extended to continue to provide a grant to eligible manufacturers or importers. *[Schedule 1, items 1 and 2 of the Energy Grants (Cleaner Fuels) Scheme Amendment Bill 2011]*

LPG

1.30 LPG is the generic name for mixtures of light hydrocarbon gas, consisting of mainly propane or propane and butane that have been liquefied through compression. These gases are produced either directly through the processing of crude oil and natural gas or as a by-product of the petroleum refining process.

1.31 LPG is generally supplied as a mixture of propane and butane but it can also be supplied as 100 per cent propane. It may also include a small proportion of other hydrocarbons. In addition to being used as a transport fuel, LPG containing propane only is used for a variety of purposes including commercial and domestic cooking, drying, heating and water heating. *[Schedule 1, item 3 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.32 LPG is not currently subject to excise or excise-equivalent customs duty.

1.33 Under these amendments fuel excise and excise-equivalent customs duty is imposed on LPG at the point of manufacture or importation.

1.34 The *Excise Regulations 1925* and the *Customs Regulations 1926* will be amended to provide an automatic remission of duty where the LPG is supplied for a non-transport use.

1.35 Accordingly, licensed manufacturers and holders of excise storage licences will apply an automatic remission for LPG used or supplied for non-transport use. No remission will apply for LPG used or supplied for a transport use or for a mixed use. *[Schedule 1, items 3 and 5 to 7 of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

Example 1.1: LPG is excisable but an automatic remission is available

Elizabeth manufactures LPG. Elizabeth supplies the LPG to Brian for a non-transport use. The LPG is excisable. However, as Elizabeth supplies the LPG to Brian for a non-transport use, she applies an automatic remission to the LPG. This means that the duty liability on the fuel is extinguished, and Elizabeth does not have to remit excise duty in relation to the LPG supplied to Brian.

Example 1.2: LPG is excisable and automatic remission is not available

Aaron manufactures LPG. Aaron delivers the LPG to Christopher in a bulk tank for transport and non-transport use. The LPG is excisable. As Aaron supplies the LPG to Christopher for mixed use, he cannot apply an automatic remission to the LPG. This means that Aaron must remit excise duty in relation to the LPG supplied to Christopher. Christopher may be entitled to a fuel tax credit for his eligible non-transport use.

1.36 **LPG** is defined in the legislation to include liquid propane, liquid mixtures of propane and butane; liquid mixtures that are either predominantly propane and butane mixtures or predominantly butane with other light hydrocarbons. *[Schedule 1, items 3 and 33 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011; Schedule 1, item 1 of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011; Schedule 1, item 2 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

1.37 Accordingly, an excisable product does not come into existence until such time as the relevant gases are changed into a liquid form.

1.38 LPG is also not subject to excise where it is used at an excise manufacturer's licensed premises to manufacture petroleum condensate, stabilised crude petroleum oil, LNG, LPG or other hydrocarbons.

[Schedule 1, items 7 and 10, section 77HB of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]

1.39 In recognition of the lower energy content of LPG compared to petrol or diesel, excise and excise-equivalent customs duty is imposed on LPG at a lower rate. Consequently, the full rate of taxation on LPG is 25 cpl.

1.40 These amendments impose excise and excise-equivalent customs on LPG at a final rate of 12.5 cpl, reflecting the 50 per cent discount for the alternative fuels. The Government will undertake a review of the taxation arrangements for LPG in 2015.

1.41 The policy intention is to levy fuel tax on LPG only when it is used for a transport purpose. Fuel tax may, for example, apply where an unlicensed party acquires LPG from a licensed party for further sale where the end use of the product is not known.

Example 1.3

The Camille Manufacturing Company supplies LPG that it manufactures to Sebastien LPG, a marketing company which has storage facilities that are excise licensed. Sebastien LPG marketing company then supplies LPG to its distributor, Isobelle LPG. Isobelle LPG is contracted to deliver LPG to tanks for use by households at residential premises. The Tax Office has granted a continuous movement permission for the Camille manufacturing company to move the LPG underbond to Sebastien LPG and for Sebastien LPG to move the LPG underbond to Isobelle LPG.

As Isobelle LPG is licensed and is supplying the LPG for a non-transport use, it can apply an automatic remission to the LPG supplied to the residential premises.

Isobelle LPG must provide a notice (see the discussion on notices under heading 'Notices and penalties') to the householder that excise duty has not been paid on the LPG, and there are penalties in diverting the LPG to a transport use.

Example 1.4

The same facts apply as Example 1.3 except that Isobelle LPG is not licensed for excise purposes. Sebastien LPG knows that Isobelle LPG only distributes LPG to residential premises for non-transport use. Therefore Sebastien LPG is able to apply an automatic remission to the

LPG when it is supplied to Isobelle LPG. Therefore no excise is paid on this LPG.

Sebastien LPG must provide a notice (see under heading 'Notices and penalties') to Isobelle LPG and Isobelle LPG must in turn provide a notice to householders advising that excise duty has not been paid on the LPG, and the penalties for diverting the LPG to a transport use.

Example 1.5

Barbeque Co buys filled LPG barbeque cylinders directly from a licensed LPG manufacturer. As the LPG is not going to be used for a transport application, the LPG manufacturer can apply an automatic remission to the LPG sold to Barbeque Co.

The LPG manufacturer must provide a notice to Barbeque Co that excise duty has not been paid on the LPG and that there are penalties for diverting the LPG to a transport use.

Fuel tax credits

1.42 Distributors of LPG on which excise duty has been paid will be entitled to claim a fuel tax credit in relation to the LPG they supply in the following circumstances:

- the LPG has been acquired to make a supply;
- the LPG is supplied to a tank at residential premises or a tank that supplies two or more residential premises and may include business premises; and
- the tank is not for use in supplying LPG for transport use.

[Schedule 1, items 16 to 21 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]

1.43 It is expected that the availability of fuel tax credits to the supplier will be passed on to the end user in the form of a lower price.

1.44 A new definition of 'residential premises' has been inserted into the *Fuel Tax Act 2006*. *[Schedule 1, item 34 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.45 Packagers of LPG on which excise duty has been paid will be entitled to claim a fuel tax credit in relation to the LPG that is packaged if:

- the LPG has been acquired for packaging;

- the LPG is packaged in containers with a capacity of 210 kilograms or less; and
- the LPG is not supplied for a transport use;

[Schedule 1, items 16 to 21 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]

Example 1.6

DistroCo is not licensed for excise purposes and acquires bulk LPG for both transport and non-transport use. Accordingly, the LPG they acquire has been subject to duty. DistroCo packages and sells a range of LPG products for transport and non-transport use. DistroCo packages and sells 9 kilogram LPG gas bottles for sale to a service station. The service station then on-sells these gas bottles to customers.

Steve is a customer of the service station and on 24 December 2011, he buys two of the gas bottles. He uses one of the gas bottles for his BBQ and the other for his patio heater.

Because DistroCo packaged the LPG in containers of 210 kilograms capacity or less and the other requirements are met, DistroCo is entitled to a fuel tax credit for the excise or excise-equivalent customs duty that it paid on the LPG.

It is expected that DistroCo and the service station will sell the gas bottles at a price that reflects the availability of fuel tax credits.

1.46 Where LPG is delivered excise paid to a distributor's business customer for end use and the business customer has a tank capacity of greater than 210 kilograms, a fuel tax credit is available to the business customer under the existing operation of the *Fuel Tax Act 2006* for eligible use of the fuel.

Notices and penalties

1.47 Sellers of LPG are required to provide a notice to buyers where they supply LPG on which excise has not been paid because an excise remission applies in relation to the LPG at the time of the supply. This requirement applies to sellers that are excise licensed, holders of excise storage licences, holders of permissions issued under section 61C of the *Excise Act 1901*, or unlicensed sellers who acquire the LPG from a licensed seller and receive such a notice. *[Schedule 1, item 11, subsections 77L(1) and (2) of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.48 The notice must set out that excise has not been paid on the LPG supplied and explain the penalties that apply for unlawful sale or use of the LPG. A regulation-making power enables rules concerning the manner and form of the notice to be prescribed as well as circumstances in which a notice is not required to be given. This will enable retailers that sell LPG camping and barbeque bottles and similar small LPG cylinders to be excluded from the notice requirements. A person commits an offence if they are required to give notice and fail to do so. *[Schedule 1, item 11, subsections 77L(3) to (5) of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.49 Penalties may apply where LPG has not been subject to excise and it is later used or sold for a transport use.

1.50 Firstly, where LPG is supplied to a person, a penalty equal to twice the amount of duty payable on the LPG is payable by the user of LPG if:

- they acquired the LPG and used the fuel for a transport use (other than a forklift or similar vehicle used off-road); and
- the fuel was subject to an excise remission at the time of use.

[Schedule 1, item 11, section 77M and item 14 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]

1.51 The term ‘excisable use’ is used to refer to use of LPG for a transport use in an engine in a vehicle or vessel by filling the fuel tank or another tank connected to the engine. The supply of fuel to a forklift used mainly off-road or a similar vehicle prescribed by regulations does not constitute an excisable use. *[Schedule 1, item 2 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.52 A penalty of two years imprisonment or the greater of 500 penalty units and five times the excise duty avoided applies to a seller of LPG if:

- the seller intentionally sells the LPG knowing it will be used for a transport use (other than a forklift or similar vehicle off-road) or is reckless as to whether the LPG will be used for such a purpose; and
- the LPG is used for such a purpose at the time at which an LPG remission applies.

[Schedule 1, items 12 and 13 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]

1.53 The penalty is the same as that imposed by section 117B of the *Excise Act 1901* that applies to the sale of excisable goods on which excise has not been paid. The penalty applies to deter both licensed and unlicensed sellers making financial gains from unlawfully selling LPG that has not been subject to excise for transport use. For example, LPG sellers will commit an offence where LPG is delivered, under remission, to a bulk tank at a retail service station, or other premises where the fuel will clearly be used for a transport purpose, such as where it can be seen that the facility has vehicle refuelling equipment connected. The presence of such equipment evidences an intention to use the LPG for a transport purpose (other than use in a forklift or similar vehicle off-road).

1.54 The amendments introduce a definition of ‘apply’ into the *Excise Act 1901* and also a definition of ‘excisable LPG’. These definitions are used in the penalty and notice provisions to identify situations in which an automatic remission of LPG has been applied by an excise licensed party and where LPG has been used in circumstances in which excise ought to have been payable. *[Schedule 1, items 1, 2, 4 and 5 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.55 Transitional rules phase in the application of excise and excise-equivalent customs duty for LPG as follows. *[Schedule 1, items 7 to 11 of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011; Schedule 1, Parts 1 and 3 to 6 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

Table 1.1: Rate of excise and excise-equivalent customs duty for LPG during the transitional period (cpl)

<i>1 Dec 2011 to 30 June 2012</i>	<i>2012-13</i>	<i>2013-14</i>	<i>2014-15</i>	<i>From 1 July 2015 Final rate</i>
2.5	5.0	7.5	10.0	12.5

1.56 The final rate of excise and excise-equivalent customs duty of 12.5 cpl applies to LPG from 1 July 2015. *[Schedule 1, item 11, subitem 10.19A in the table of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011; Schedule 1, Part 6, Division 2 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

1.57 The ordinary rules of licensing for manufacturing excisable goods and importing goods subject to customs duty apply and manufacturers of alternative fuels need to be licensed under the excise system. However, special transitional provisions provide additional time for manufacturers of gaseous fuels who are not currently licensed to obtain manufacturer’s licences. The transitional arrangements also provide permission to deliver goods for home consumption without entry.

[Schedule 2, items 1 to 4 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]

1.58 Under the transitional licensing rules manufacturers of LPG have until 31 January 2012 to apply for a manufacturer's licence.

LNG

1.59 LNG is produced from natural gas that is cooled to the point that it condenses to a liquid (approximately -161°C). LNG is typically exported but is also used as a transport fuel, generally in heavy-duty long range road transport.

1.60 LNG is not currently subject to excise or excise-equivalent customs duty.

1.61 Under these amendments fuel excise and excise-equivalent customs duty is imposed on LNG at the point of manufacture or importation. *[Schedule 1, items 4 and 7 of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011; Schedule 1, Part 1, item 10 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

1.62 Given that most LNG that is produced is not for transport use, automatic remissions of excise and excise-equivalent customs duty on LNG are available where it is used for purposes other than in an internal combustion engine for use in a vehicle.

1.63 LNG is also not subject to excise where it is used at an excise manufacturer's licensed premises to manufacture petroleum condensate, stabilised crude petroleum oil, LNG, LPG or other hydrocarbons. *[Schedule 1, item 10, section 77HB of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.64 The automatic remission for prescribed classes of LNG removes the obligation to remit duty by an entity that is a licensed manufacturer or the holder of licensed storage facilities, where the LNG is for a non-transport use. An automatic remission will be included in the excise and customs regulations.

1.65 Excise and excise-equivalent customs duty is imposed on LNG that is used in an internal combustion engine for transport use. The appropriate unit of measurement for LNG and CNG is cents per kilogram, rather than cpl as with the other alternative fuels. The final rate of 26.13 cents per kilogram that applies from 1 July 2015 reflects the energy content of LNG, with a discount of 50 per cent because it is an alternative fuel. *[Schedule 1, item 11, subitem 10.19B in the table of the Excise Tariff Amendment*

(Taxation of Alternative Fuels) Bill 2011; Schedule 1, Part 6, Division 1 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]

1.66 Transitional rules phase in the application of excise and excise-equivalent customs duty for LNG as follows. *[Schedule 1, items 7 to 11 of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011; Schedule 1, Parts 1 and 3 to 6 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

Table 1.2: Rate of excise and excise-equivalent customs duty for LNG during the transitional period (cents per kilogram)

<i>1 Dec 2011 to 30 June 2012</i>	<i>2012-13</i>	<i>2013-14</i>	<i>2014-15</i>	<i>From 1 July 2015 Final rate</i>
5.22	10.45	15.67	20.9	26.13

1.67 The ordinary rules of licensing for manufacturing excisable goods and importing goods subject to customs duty apply and manufacturers need to be licensed under the excise and customs systems. However, special transitional provisions provide additional time for manufacturers of gaseous fuels who are not currently licensed to obtain manufacturer's licences. The transitional arrangements also provide permission to deliver goods for home consumption without entry. *[Schedule 2, items 1 to 4 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.68 Under the transitional licensing rules manufacturers of LNG have until 31 January 2012 to apply for a manufacturer's licence.

CNG

1.69 CNG is produced from natural gas, which is compressed. CNG is used in some bus fleets, street sweepers and garbage collection vehicles. There is no significant use of CNG in cars in Australia at this stage.

1.70 CNG is not currently subject to excise or excise-equivalent customs duty.

1.71 Under these amendments fuel excise is imposed on CNG at the point of manufacture, which is when the natural gas is compressed for use in a vehicle, or when it is imported for use in a vehicle. *[Schedule 1, item 4 of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011; Schedule 1, Part 1, item 11 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

1.72 Excise is imposed on CNG at a final rate of 26.13 cents per kilogram. This reflects that the appropriate unit of measurement for natural gas, including LNG and CNG, is cents per kilogram, rather than cpl that is used for the other alternative fuels. The final rate of 26.13 cents per kilogram reflects the energy content of CNG, with a discount of 50 per cent because it is an alternative fuel. *[Schedule 1, item 11, subitem 10.19C in the table of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011; Schedule 1, Part 6, Division 3 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

1.73 Similar to LNG, this rate reflects the energy content of CNG with the discount for alternative fuels.

1.74 Excise and excise-equivalent customs duty is imposed on the manufacture or importation of CNG where it is manufactured or imported for use in vehicles. However, excise does not apply:

- where CNG is used or intended for use for something other than as a fuel for a vehicle;
- to the extent the process of manufacture is not part of the activities of the enterprise, for example, excise is not imposed where natural gas is compressed in home refuelling systems for non-business purposes; or
- where CNG is used in a forklift off-road or other vehicles prescribed by regulation.

[Schedule 1, item 10, section 77HA of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]

Example 1.7: CNG manufacture in an enterprise

A taxi driver compresses CNG in a home refuelling system for use in their taxi. Excise applies to the CNG as it is used as fuel in a vehicle in the course of carrying on an enterprise.

Example 1.8: CNG manufacture for private purposes

David has CNG compression equipment installed at his residence and he uses it solely to fill the tank of his own privately used CNG powered car. Excise does not apply as the CNG has not been manufactured in the course of carrying on an enterprise.

1.75 Transitional rules phase in the application of excise and excise-equivalent customs duty for CNG as follows. *[Schedule 1, items 7 to 11 of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011; Schedule 1, Parts 1 and 3 to 6 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

Table 1.3: Rate of excise and excise-equivalent customs duty for CNG during the transitional period (cents per kilogram)

<i>1 Dec 2011 to 30 June 2012</i>	<i>2012-13</i>	<i>2013-14</i>	<i>2014-15</i>	<i>From 1 July 2015 Final rate</i>
5.22	10.45	15.67	20.9	26.13

1.76 The final rate of excise and excise-equivalent customs duty of 26.13 cents per kilogram applies from 1 July 2015. *[Schedule 1, item 11, subitem 10.19C in the table of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011; Schedule 1, Part 6, Division 3 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

1.77 The ordinary rules of licensing for manufacturing excisable goods and importing goods subject to customs duty apply and manufacturers need to be licensed under the excise and customs systems. However, special transitional provisions provide additional time for manufacturers of gaseous fuels who are not currently licensed to obtain manufacturer's licences. The transitional arrangements also provide permission to deliver goods for home consumption without entry. *[Schedule 2, items 1 to 4 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.78 Under the transitional licensing rules manufacturers of CNG have until 31 January 2012 to apply for a manufacturer's licence.

Fuel tax credits

1.79 Fuel tax credits are available to eligible businesses to provide a credit for the fuel tax included in the price of fuel used in business activities, machinery, plant, equipment and heavy vehicles. Fuel tax credits remove or reduce the incidence of fuel tax from business inputs.

1.80 The purpose of fuel tax credits is to avoid distorting business investment decisions and behaviour that would occur through taxing business inputs.

1.81 The result is that fuel tax is only effectively collected from fuel consumed in:

- vehicles for private use and for other private purposes;
- business use on-road in motor vehicles with a gross vehicle mass of more than 4.5 tonnes but only to the extent of the road-user charge;
- business use in vehicles of 4.5 tonne gross vehicle mass or less used on public roads; and
- certain industry use (for example, quarrying, manufacturing and construction industries) in off-road applications. These activities are currently entitled to a fuel tax credit of 19.0715 cpl (which is 50 per cent of the full rate of 38.143 cpl). The full rate applies to these activities from 1 July 2012.

1.82 These amendments result in entitlement to fuel tax credits being extended to include excise and excise-equivalent customs duty payable on LPG, LNG, and CNG used in carrying on an enterprise. No specific amendment is required to achieve this as fuel tax credits apply in general terms to taxable fuels, that is, fuels to which excise or excise-equivalent customs duty has been imposed.

1.83 The amount of fuel tax credits is reduced in certain circumstances including grants or subsidies payable by the Commonwealth and by the amount of any road-user charge for heavy vehicles determined by the Transport Minister. From 1 July 2010, the road-user charge is 22.6 cpl. Only off-road use of the fuels potentially qualifies for fuel tax credits as the road user charge exceeds the rate of duty that applies for on-road use of LPG, LNG and CNG.

1.84 The amendments include provisions for working out the rate of fuel tax, grant or subsidy. Entitlement to fuel tax credits for fuel acquired in a financial year during the transition period are determined (subject to the road-user charge) based on the excise or excise-equivalent customs duty rate applicable at the date of acquisition, manufacture or import. *[Schedule 1, items 25, 26 and 32 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.85 In working out the fuel tax payable on blended fuels, the amendments include a mechanism which sets the entitlement for fuel tax credits for blends directly in the legislation. A regulation-making power exists to allow specific fuel blends to be prescribed which qualify for a

full fuel tax credit based on the petrol or diesel rate of excise paid. The regulations will include blends that currently qualify for fuel tax credits at the petrol and diesel rate. This includes B5, B20 and E10. *[Schedule 1, items 27 and 28 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.86 Where the specific blends are not prescribed in the regulations, the fuel tax credit entitlement is based on the amount of duty payable on the individual fuels that make up the blend. The ratio of the alternative fuel and the petrol or diesel in the blend is based on the minimum percentage of the petrol or diesel that is set out in the terms and conditions for the sale of the fuel. Where evidence is held of the specific ratios of the fuels in the blend purchased, then that ratio can be used to determine the fuel tax credit entitlements of the fuel blend. *[Schedule 1, item 28 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.87 This removes any uncertainty in claiming fuel tax credits for blends that can contain different proportions of fuels to make up the blend. For example, E85 is a blend containing ethanol and petrol, however it can contain between 70 per cent and 85 per cent ethanol. In terms of calculating the fuel tax credit, E85 is treated as containing 85 per cent ethanol and 15 per cent petrol. Similarly, this rule also applies to biodiesel blends that contain greater than 20 per cent biodiesel.

1.88 In the case of ethanol, the fuel tax credit is calculated taking into account any grant paid under the contractually based Ethanol Production Grant Program. This ensures that both domestically produced and imported ethanol is treated as having been domestically manufactured for fuel tax credit purposes with a grant applying of 38.143 cpl, other than for any blends for which fuel tax credits apply, at the petrol or diesel duty rate for the whole blend. The change reflects that claimants of fuel tax credits for ethanol are unlikely to know the source of ethanol purchased and accordingly, are able to apply a standardised approach to claiming fuel tax credits. The fuel tax credit rate applicable is the relevant rate determined on the day of purchase. *[Schedule 1, item 28 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.89 A determination-making power has been provided which will allow the Commissioner to determine in writing the proportions of fuel blends that do not meet the above rules. This would include situations in which fuel blends include three or more different fuels. *[Schedule 1, item 28 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.90 An amendment is made to ensure that the denial of an entitlement to a fuel tax credit applies if another entity was previously entitled to a fuel tax credit, regardless of whether the fuel tax credit relates to an entitlement for an enterprise or a fuel tax credit for a non-business taxpayer. *[Schedule 1, items 22 to 24 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

Amendments to the *Customs Tariff Act 1995*

1.91 The amendments to the *Customs Tariff Act 1995* contained in the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011 provide rates of duty for imported fuels at rates that are equivalent to the excise duty set out in the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011, for these goods.

1.92 The amendments to the *Customs Tariff Act 1995* also include the creation, in Schedule 3, of new subheadings to separately identify blends of ethanol and gasoline and blends of diesel and other substances. This enables the calculation of customs duty for such blends based on the appropriate duty rate for each component, equivalent to the provisions of section 6G of the *Excise Tariff Act 1921*. [*Schedule 1, Part 1, Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011*]

1.93 The international Harmonized Commodity Description and Coding System, commonly referred to as the Harmonized System, forms the basis of Australia's Customs Tariff. The World Customs Organization administers the Harmonized System with reviews approximately every five years. Signatory parties, including Australia, are required to implement changes resulting from the fourth review of the Harmonized System on 1 January 2012.

1.94 A number of the amendments contained in the fourth review impact on the *Customs Tariff Act 1995* provisions relating to fuels. In particular, these amendments create a new subheading 2710.20.00 for certain biodiesel blends, renumber subheading 2710.11 (light oils and preparations) as 2710.12 and create a new heading 3826 for biodiesel and other biodiesel blends.

1.95 Consequently, the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011 contains amendments effective from 1 January 2012, that reflect the new subheadings that enter into force from that date, as a result of the fourth review of the Harmonized System. [*Schedule 1, Part 2 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011*]

1.96 The amendments contained in the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011 create a new Additional Note 11 to Chapter 22 to clarify the classification of ethanol denatured with gasoline. The Note provides that if the proportion of gasoline (or other petroleum products) is greater than 1.5 per cent by volume, such goods are classified as mixtures in headings 3824 or 2710. [*Schedule 1, Part 1, item 1 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011*]

1.97 The amendments contained in the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011 also impose excise-equivalent rates of duty for certain gaseous fuels. The rates of duty are the same as the rates provided under the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011. The products are:

- LNG classified to subheading 2711.11.00;
- LPG classified to subheadings 2711.12.10 and 2711.13.10; and
- CNG classified to subheading 2711.21.10.

[Schedule 1, Part 1 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011].

1.98 In the case of LPG, the amendments create a new Additional Note 2 to Chapter 27 to define this product as:

- liquid propane;
- a liquid mixture of propane and butane;
- a liquid mixture of propane and other hydrocarbons that consists mainly of propane; or
- a liquid mixture of propane, butane and other hydrocarbons that consists mainly of propane and butane.

[Schedule 1, Part 1, item 2 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]

1.99 The amendments provide for new domestic subheadings 2711.12.10 and 2711.13.10 that refer to the above definition and apply the excise-equivalent rates. Other products classified in these subheadings that fall outside the definition continue to be free of customs duty (subheadings 2711.12.90 and 2711.13.90). *[Schedule 1, Parts 1 to 7 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

1.100 Schedules 5 to 8 to the *Customs Tariff Act 1995* specify rates of customs duty for certain goods, including petroleum based fuels, that are defined as US, Thai, Chilean or Association of South East Asian Nations (ASEAN) originating goods, under the Australia-US Free Trade Agreement, the Thailand-Australia Free Trade Agreement, the Australia-Chile Free Trade Agreement and Australia's regional agreement with ASEAN and New Zealand, the ASEAN-Australia-New Zealand Free Trade Agreement, respectively. The Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011 creates new items in each of

these Schedules and imposes rates of duty that reflect the changes in Schedule 3. *[Schedule 1, Parts 1 to 7 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]*

1.101 The new rates of duty in Schedules 5 to 8 are in accordance with the relevant Free Trade Agreements.

1.102 The amendments to the *Customs Tariff Act 1995* (Schedules 3 to 8) ensure that the new rates of duty applicable to fuels applies to goods imported from all sources. These amendments also ensure that the same rate of customs duty applies to imported goods as the excise duty imposed under the *Excise Tariff Act 1921* on those goods when domestically produced.

Application and transitional provisions

Application provisions

- 1.103 These amendments apply to fuel:
- acquired, manufactured or imported on or after 1 December 2011;
 - imported into Australia before 1 December 2011 where the time for working out the rate of import duty on the goods had not occurred before 1 December 2011; and
 - on hand at licensed (or deemed licensed) premises on 1 December 2011.

[Schedule 1, items 22 and 29 and Schedule 2, item 2 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011; Schedule 1, item 12 of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011; Schedule 1, Part 7 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011]

Commencement provisions

1.104 The four Bills contained in the package are the Taxation of Alternative Fuels Legislation Amendment Bill 2011, the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011, the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011 and the Energy Grants (Cleaner Fuels) Scheme Amendment Bill 2011.

1.105 The Bills commence on Royal Assent, however, the operative provisions of the Energy Grants (Cleaner Fuels) Scheme Amendment Bill 2011 do not apply unless the other Bills in the package commence prior to 1 July 2011. Each of the other Bills in the package also do not have operative effect unless all the other Bills in the package commence on or before 1 December 2011. *[Clause 2 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011; clause 2 of the Excise Tariff Amendment (Taxation of Alternative Fuels) Bill 2011; clause 2 of the Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011; clause 2 of the Energy Grants (Cleaner Fuels) Scheme Amendment Bill 2011]*

1.106 The conditional commencement provisions in the Bills reflect that the Bills form a package and if some parts of the package are not enacted then unintended outcomes may arise.

Transitional provisions

1.107 Transitional licensing arrangements are available from 1 December 2011 for manufacturers that have excise obligations as a result of this measure. The arrangements deem a manufacturer to have a manufacturer licence, and also deem the manufacturer to have permission under section 61C of the *Excise Act 1901* under the transitional licensing arrangements to deliver LPG, LNG or CNG into home consumption after 1 December 2011. *[Schedule 2, items 1 to 4 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

Consequential amendments

1.108 The *Energy Grants (Cleaner Fuels) Scheme Act 2004* is amended from 1 July 2011. Amendments are made to the Act to continue the operation of the Act to grants for biodiesel and renewable diesel. Amendments are also made to remove redundant references to LPG, LNG, CNG, ethanol and methanol because the Act will not apply to these fuels, and to update the taxation arrangements for biodiesel and renewable diesel. *[Schedule 1, items 1 to 15 of the Energy Grants (Cleaner Fuels) Scheme Amendment Bill 2011; Schedule 1, item 27 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*

1.109 References in the *Fuel Tax Act 2006* to the intention for gaseous fuels to be assessed under that Act from 2011 are repealed. In line with the existing excise and excise-equivalent customs duty arrangements that apply, petrol, diesel, ethanol and biodiesel and renewable diesel continue to be taxed under the relevant excise and customs legislation while, LPG, LNG and CNG commence to be taxed under the relevant excise and customs legislation *[Schedule 1, items 15 and 31 of the Taxation of Alternative Fuels Legislation Amendment Bill 2011]*. A technical correction has also been

made [Schedule 1, item 30 of the *Taxation of Alternative Fuels Legislation Amendment Bill 2011*].

1.110 A minor amendment is made to the *Product Grants and Benefits Administration Act 2000* to remove a redundant heading. The information gathering powers under Part 9 of the *Product Grants and Benefits Administration Act 2000* continue to operate in relation to the *Energy Grants (Cleaner Fuels Scheme) Act 2004*. [Schedule 1, item 35 of the *Taxation of Alternative Fuels Legislation Amendment Bill 2011*]

1.111 Section 58 in the *Excise Act 1901* refers to LPG. This remains in place from a previous taxation arrangement that resulted in LPG being subject to excise. This reference is redundant and is removed to ensure that there is no conflict between the taxation of alternative fuel provisions and the redundant provision. The amendment ensures that, as with other goods which are exported, LPG which is exported is not subject to excise. [Schedule 1, items 6 and 7 of the *Taxation of Alternative Fuels Legislation Amendment Bill 2011*]

1.112 The Commissioner has the power to determine rules for working out the energy content of excisable goods. [Schedule 1, items 8 and 9 of the *Taxation of Alternative Fuels Legislation Amendment Bill 2011*]

1.113 As part of the fourth review of the Harmonized System, a change to the customs definition of ‘biodiesel’ is expected to be made on 1 January 2012. This will result in a number of subheadings in Schedule 3 to the *Customs Tariff Act 1995* being repealed and new subheadings being inserted dealing with biodiesel and with mixtures of biodiesel and other substances respectively. [Schedule 1, Part 2 of the *Customs Tariff Amendment (Taxation of Alternative Fuels) Bill 2011*]

1.114 The TAA 1953 is amended to add the LPG penalty in new section 77M of the *Excise Act 1901* to the index of tax-related liabilities under other Acts. [Schedule 1, item 36 of the *Taxation of Alternative Fuels Legislation Amendment Bill 2011*]

Chapter 2

Regulation impact statement

2.1 The regulation impact statement below had been prepared prior to the Government's decision on 11 May 2011 to make changes to its announced alternative fuels policy position. The decision was in response to negotiations with independent members of Parliament. Those negotiations resulted in the following changes:

- a 10 year moratorium applies to the current taxation and grant arrangements for ethanol, biodiesel, renewable diesel and methanol; and
- at the end of this period a review of the taxation and grant arrangements for these fuels would be undertaken.

Introduction

2.2 Fuel tax consists of excise on certain domestically manufactured fuels, and excise-equivalent customs duty on the relevant imported fuels. These fuels include petrol, diesel, fuel oil, kerosene, benzene, toluene, xylene, biodiesel and fuel ethanol.

2.3 The general rate of fuel tax applying to most fuels is 38.143 cents per litre (cpl).

2.4 Alternative fuels (ethanol, biodiesel and the gaseous fuels) are concessionally taxed. The gaseous fuels including liquefied petroleum gas (LPG), liquefied natural gas (LNG) and compressed natural gas (CNG), are currently outside the fuel tax system.

2.5 The effective fuel tax on domestically produced ethanol and domestically produced and imported biodiesel used in an internal combustion engine is zero. This is because the fuel tax liability is fully offset on ethanol by the ethanol production grants, administered by AusIndustry, and on biodiesel by the Energy Grants (Cleaner Fuels) Scheme, administered by the Australian Taxation Office. Imported ethanol is not offset by a grant and so is taxed at 38.143 cpl (plus an additional 5 per cent customs tariff).

2.6 The 2004-05 Budget included a measure to, from 1 July 2011, bring alternative fuels into the fuel tax net, to tax all fuels on an energy

content basis using three energy content bands and to provide alternative fuels with a 50 per cent discount to their energy content rate. Applying fuel tax to alternative fuels was to be phased in over a transitional period from 1 July 2011 until 1 July 2015. Some aspects of this policy have been legislated and some parts have not. The Assistant Treasurer and Minister for Financial Services and Superannuation announced on 24 January 2011 that the start date of the measure would be deferred until 1 December 2011.

Assessing the problem

2.7 The start date for the taxation of alternative fuels has been delayed until 1 December 2011 to allow industry time to prepare for its introduction. Industry also requires certainty about future movements in fuel tax in order to undertake investment decisions.

2.8 Petrol and diesel are currently taxed under the fuel tax system. Alternative fuels are close substitutes for petrol and diesel and their current treatment of no effective fuel tax (except for imported ethanol) distorts consumption and production decisions. It could encourage greater consumption and production of these fuels than optimal resource allocation decisions would dictate, decreasing economic efficiency.

2.9 Fuel tax can be considered as a proxy road-user charge, in the absence of more direct user charging approaches. The consumption of fuel is an indication of how often a vehicle is used, and therefore is one indicator of the contribution of the vehicle to the costs of road congestion, road maintenance and road construction. It is acknowledged there are other factors that contribute to these costs (such as the weight of the vehicle) and factors that determine fuel use that do not impact on these costs (such as the fuel efficiency of the vehicle). However, to the extent that fuel tax can play a role as a proxy road-user charge, the costs that it is reflecting are irrespective of the type of fuel used. If fuel tax is to be effective in reflecting the costs associated with road use, it should apply to all fuels used in an internal combustion engine. The exclusion of alternative fuels from the fuel tax net means that fuel tax is not as effective as it could be in reflecting these costs.

2.10 The current treatment of no effective fuel tax on alternative fuels (except for imported ethanol) recognises arguments that the development of these fuels helps to address environmental, fuel security and regional development issues. As other policy mechanisms are developed that more directly address these issues, there will be less need to have a differential treatment of the alternative fuels in the fuel tax system. The use of

ethanol is supported by the mandated addition of ethanol to petrol in New South Wales (NSW) and moves to mandate the addition of ethanol to petrol in Queensland. The conversion of passenger vehicles to use LPG is supported by the LPG Vehicle Scheme. To the extent that alternative fuels emit less carbon, the introduction of a carbon charge will reduce their price compared to other higher emitting fuels. Close consideration will be given to how these other policy mechanisms interact with the fuel tax system.

2.11 The announcement of the measure in the 2004-05 Budget means that industry is aware of and has been expecting the proposed changes although only certain elements of the announced policy have been legislated. Significant deviations from the announced policy that impact on the tax liability of the affected industries may unsettle investment decision making.

Policy objective

2.12 The first objective is to improve the effectiveness and efficiency of the fuel market. Making alternative fuels liable for fuel tax will address a current distortion that can result in a poor allocation of resources between alternative fuels and petrol and diesel.

2.13 The second objective is to improve the performance of fuel tax as a proxy for a road-user charge. For fuel tax to better reflect the road costs that result from vehicle use, it should apply to all fuels used in a combustion engine.

2.14 The third objective is to recognise the environmental, energy security and regional development benefits that can flow from the use of alternative fuels. This objective needs to be weighed against the first two objectives, that is, the extent to which assisting the alternative fuels industry undermines the efficiency of the fuel market and the effectiveness of fuel tax as a proxy road-user charge.

2.15 The fourth objective is to provide the fuel industry and fuel users with certainty as to the future direction of fuel tax policy so that they have confidence to make future investment decisions and consumption choices. Providing them with certainty also requires that they be given adequate time to prepare for the changes to fuel tax.

2.16 The fifth objective is to provide the alternative fuel industry with an appropriate transition period to be able to adjust to the changes to fuel tax.

Implementation options

Option 1: Energy content based fuel taxation with a 50 per cent discount for alternative fuels to be phased in over a transitional period from 1 December 2011 until 1 July 2015

2.17 This option is to deliver on the policy outcomes announced in the 2004-05 Budget but to consider some simpler implementation options.

2.18 Under Option 1:

- All fuels would fall into one of three energy bands according to their energy content: high (energy content greater than 30 megajoules per litre); medium (between 20-30 megajoules per litre) and low (less than 20 megajoules per litre).
- The tax rate applying to these fuels would be proportional to their energy band at a rate of 100 per cent, 66 per cent and 45 per cent respectively of the excise rate for petrol and diesel.
- Alternative fuel tax rates will be set at a 50 per cent discount to their energy content rate.
- Fuel tax will be levied on the producers or importers of biofuels and ethanol. For the gaseous fuels, the tax will be levied on the marketers, with consultation to occur with the industry on implementation.
- Consultation could occur with industry to determine whether to proceed with the approach adopted in the 2004-05 Budget announcement, that is legislating the final fuel tax rates from 1 December 2011 with the transition to these final rates achieved through phasing out the Energy Grants (Cleaner Fuels) Scheme, or whether another mechanism is preferable.
- Following stakeholder consultation, the best mechanism to deliver these subsidies could be agreed between relevant Ministers.

2.19 A review of the assistance to alternative fuels could be undertaken after 1 July 2015 in light of the outcomes of the taxation measures themselves, broader energy issues, the implementation of a carbon price and also with reference to the Australia's Future Tax System recommendations.

2.20 The Assistant Treasurer and Minister for Financial Services and Superannuation could undertake consultation on implementing the measures together with the Minister for Resources and Energy and the Minister for Sustainability, Environment, Water, Population and Communities.

Option 2: Energy content based fuel taxation with a 50 per cent discount for alternative fuels to be phased in from 1 December 2011 with provisions to address the sudden loss in the relative tax advantage of domestic ethanol due to the previously announced measure, and to tax natural gas (LNG and CNG) on a mass rather than volume basis.

2.21 This option is consistent with Option 1 in terms of the outcomes at the end of the transition period. The proposal is also consistent with Option 1's transitional treatment of the gaseous fuels and biodiesel, the proposed consultation on the delivery mechanism to assist alternative fuels in the transition period, and a review of the overarching policy. Option 2 differs from Option 1 in that firstly, it smooths the change in the relative tax advantage of domestic ethanol vis-à-vis imported ethanol and extends the transition period and secondly, introduces the mass based taxation of natural gas.

2.22 The smoothing of the transition path for domestic ethanol will occur through: removing entitlements to the Energy Grants (Cleaner Fuels) Scheme for ethanol; setting the excise rate for ethanol at its full energy content rate from 1 December 2011 (25 cpl) falling to 12.5 cpl on 1 July 2015; and providing direct subsidies to domestic producers and phasing them down over the transition period until 1 July 2020 (see Tables 2.1 to 2.4 for more details on the transition path).

2.23 Option 2 also removes natural gas (LNG and CNG) from the volumetric based three tax bands and sets the tax rate unit of measure as the kilogram as this is the unit used in commercial transactions. Natural gas will be subject to a 26.13 cents per kilogram tax rate which is consistent with the excise rate for petrol and diesel after adjusting for the energy content differential and providing the 50 per cent discount.

Option 3: Full taxation of alternative fuels

2.24 Option 3 is the same as Option 1 except that no discount would be provided to the alternative fuels. This option would be phased in over 10 years from 1 December 2011 to 1 July 2020.

2.25 There would be two phases to this option. Phase one would be identical to Option 1. In phase two, full energy content based fuel tax

would be phased in by even steps from 1 July 2016 until 1 July 2020 through changes to legislated fuel tax rates.

Option 4: Maintain current taxation arrangements

2.26 This option would maintain existing taxation arrangements for alternative fuels.

- Petrol and diesel would be taxed at the rate of 38.143 cpl.
- Ethanol would be taxed at the rate of 38.143 cpl with this tax liability fully offset by ethanol production grants for domestically produced ethanol.
- Biodiesel would be taxed at the rate of 38.143 cpl with the full tax liability offset by Energy Grants (Cleaner Fuels) Scheme grants.
- Gaseous fuels would not be subject to fuel tax.

Assessment of impacts

Use of alternative fuels

2.27 Overall, alternative fuels make up less than 7 per cent of the transport fuels used in Australia. LPG is the main alternative to petrol and diesel as a transport fuel and it accounts for 6 per cent of Australia's fuel consumption.

Production of alternative fuels

2.28 Australian fuel ethanol production was estimated at 112 million litres in 2007. There are currently three ethanol producers in Australia.

2.29 Biodiesel production was estimated at 59 million litres in 2007. In 2010, there were seven biodiesel plants in Australia.

2.30 In 2008-09 Australia produced a total of 5.4 billion litres of LPG, of which domestic sales were approximately 4.0 billion litres. Of this 56 per cent was used for automotive use.

Price impacts

2.31 Under Option 1 the final fuel tax rate for LNG, LPG and ethanol when fully phased would be 12.5 cpl (50 per cent of the medium energy content band rate of 25 cpl). Therefore, the maximum possible change in fuel tax imposed on E10 will be 1.25 cpl. For biodiesel, renewable diesel and CNG the final fuel tax rate would be 19.1 cpl, (50 per cent of the high energy content band rate of 38.143 cpl).

2.32 Under Option 2 the final fuel tax rate for LPG and ethanol when fully phased would be 12.5 cpl (50 per cent of the medium energy content band rate of 25 cpl). For biodiesel and renewable diesel the final fuel tax rate would be 19.1 cpl (50 per cent of the high energy content band rate of 38.143 cpl). Natural gas (LNG, CNG) will be taxed on a mass based rate of 26.13 cents per kilogram.

2.33 Under Option 3 the final fuel tax rate for LPG, LNG and ethanol when fully phased would be 25 cpl (100 per cent of the medium energy content band rate). For biodiesel, renewable diesel and CNG the final fuel tax rate would be than 38.143 cpl (or per cubic metre in the case of CNG, 100 per cent of the high energy content band rate).

2.34 Under Option 4 there will be no changes to the fuel tax rates and so there will be no influence on prices from changes to fuel tax.

2.35 The extent to which a higher fuel tax will be reflected in retail prices will depend upon the seller's ability to pass the tax on, conditional upon the competitive pressures in the industry. There are a range of other factors that also influence the price of fuels, including international prices and exchange rates, that make it difficult to separately identify any price impact from the imposition of excise.

2.36 Other policies may also impact on alternative fuels post-2011.

2.37 In the case of ethanol, the current and potential state mandates may have some impacts on the alternative fuel market.

2.38 Any price impacts will be felt by those who bear the incidence of the tax, that is, final consumers and businesses who are not eligible for fuel tax credits. Fuel tax credits offset fuel tax liability and are available for fuel used by businesses off-road and by businesses in vehicles used on-road that are greater than 4.5 tonnes.

Economic / Competition implications

2.39 Options 1, 2 and 3 will enhance competition between types of fuels in the fuel product market. The taxation-based advantage of

alternative fuels will be reduced, enhancing market efficiency, economic choice and the consequent allocation of resources.

2.40 Moving to energy bands as the basis for taxing fuel will also improve the efficiency of the fuel market. The energy density of fuels — which translates into the number of kilometres each litre of the fuel will drive a vehicle — varies for different fuels. The energy content based taxation of fuels will ensure that, as all fuels are brought into the tax system, fuels with a lower energy content are not placed at a competitive disadvantage vis-à-vis higher energy content fuels. The lower energy content fuels will have a lower tax rate to reflect that, litre for litre, they do not represent the same level of energy consumption as the high energy content fuels.

2.41 In the case of the market for ethanol, competition will be improved under Options 1, 2 and 3 over the current arrangements through the removal of the current taxation-based advantage domestic producers have over ethanol importers. Currently the ethanol production grant offsets the excise on domestically produced ethanol to effectively zero. As there is no corresponding offset for excise-equivalent customs duty, importers are currently subject to the full 38.143 cpl duty (as well as a 5 per cent customs tariff).

2.42 Both Options 1 and 3 result in a sudden loss in the relative tax advantage of domestic ethanol (from 38.143 cpl to zero) compared to imported ethanol from 1 December 2011. Such a sudden change in competitiveness may impact on the viability of the ethanol industry in Australia, particularly as it is still a developing industry. This has implications for the environmental, energy security and regional development benefits that can flow from the use of alternative fuels. Option 2 addresses this key risk by phasing out the tax differential over the transition period. The adoption of Option 4 would lose the competitive benefits from the comprehensive application of taxation to the fuel market.

Impact group identification

2.43 All four options will have a minimal impact on families, regional communities and small businesses. The major fuels used by these groups are petrol and diesel.

2.44 This proposal will not directly impact on the retail price of petrol or diesel, and thus families will not be impacted in their use of these fuels.

2.45 However, families who use alternative fuels will be affected by any price impacts of the fuel tax changes. More families in NSW can be expected to use ethanol due to the ethanol mandate. Individual consumers have also been encouraged to convert their vehicles to LPG through the LPG Vehicle Scheme which is managed by AusIndustry. The scheme offers grants to individuals who, subject to certain program eligibility criteria, convert existing vehicles to LPG or purchase new vehicles and convert them to LPG prior to registration. As at 31 January 2011, AusIndustry had paid a total of 279,220 LPG Vehicle Scheme grants at a cost of \$544,242,500.

2.46 The regions producing ethanol may be affected as competition from importers is expected to increase with the removal of the tax advantage enjoyed by the domestic ethanol producers under Options 1, 2 and 3. The three main ethanol production plants are in NSW (Manildra Group in Nowra) and Queensland (Sucrogen BioEthanol in Sarina and Dalby Bio-Refinery Ltd in Dalby). However, there is also likely to be an increase in demand as a result of the ethanol mandate in NSW and proposed mandate in Queensland.

2.47 The impact on small business will depend upon the extent to which they are entitled to full tax credits to offset the fuel tax. A fuel tax credit is available for business vehicles used off-road, or on-road vehicles greater than 4.5 tonnes. The fuel tax credit is reduced by the amount of the road-user charge for on-road vehicles.

2.48 Options 1, 2 and 3 will have a small impact on those small businesses with a heavy dependence on alternative fuels, for example small businesses in the transport sector such as taxi services that are not eligible for fuel tax credits.

2.49 The taxi industry in Australia has been one of the major business consumers of LPG, with most Australian city-based taxi fleets moving to dedicated LPG or dual LPG/petrol fuelled vehicles.

2.50 The Australian Taxi Industry Association (ATIA) estimates that over 15,000 (or approximately 85 per cent) of the approximate 18,000 taxis in Australia operate on LPG. The Association further estimates that taxis comprise approximately 2.5 per cent of the total stock of LPG vehicles in Australia, and account for approximately 20 per cent of LPG (Autogas) sales in Australia.

2.51 The effect of including LPG in the excise system on taxi fares depends on decisions by State and Territory regulators – if the excise is passed on in full it could add approximately 3.5 cents to the average metro taxi fare trip on the introduction of a 2.5 cpl excise on 1 December 2011. This will increase to approximately 19.0 cents to the average metro taxi

fare trip when the final excise of 12.5 cpl is introduced on 1 July 2015. Assumptions: This price estimate assumes the cost of the excise is passed on in full to the customer; that the average mileage of a taxi is 18.0 litres of LPG per 100 kilometres (ATO taxi benchmarks guide for LPG use in the taxi industry; and the average metro taxi trip in Australia is 8.4 kilometres (based on Australian Taxi Industry Association Statistics).

2.52 Biodiesel, LNG and CNG are predominantly used in heavy vehicles such as metropolitan bus fleets, garbage trucks and line haulage. The extent to which they will bear the incidence of the tax will depend upon their entitlement to fuel tax credits.

Producers

Ethanol

2.53 Currently, to legally manufacture ethanol, a person must hold an excise manufacture licence. This will not change under any of the options. Currently, the excise payable is offset by an ethanol production grant that is paid separately by the Department of Resources, Energy and Tourism after the excise return is lodged and based on evidence such as bank statements. Options 1, 2 and 3 recommend that direct assistance continue to domestic ethanol producers over the phase in period, through the provision of grants to offset a proportion of the excise paid. Options 1 and 3 extend the assistance to ethanol importers so that the tax differential between imported and domestically produced ethanol would cease on 30 November 2011. Option 2 does not extend the transitional assistance to importers so that the tax differential would phase out over the transition period. All three options propose that consultations be undertaken with stakeholders to determine whether a lower compliance cost approach can be adopted.

2.54 Option 4 will maintain the current arrangements and will, therefore, not impact on compliance costs for these producers unless they have made commercial arrangements based on the announced policy.

Biodiesel

2.55 Currently, in order to legally manufacture biodiesel, a person must hold an excise manufacture licence. This will not change under any of the options. Provided the fuel meets the Biodiesel Fuel Standard, any excise payable is currently offset by an Energy Grants (Cleaner Fuel) Scheme entitlement which is made available at the same time as they lodge their excise return. Options 1, 2 and 3 phase out the Energy Grants (Cleaner Fuel) grants for biodiesel and therefore, at the end of the phase out period, there will be reduced complexity for affected businesses. All

options include a provision to consult on whether there is a more efficient mechanism to deliver assistance to biofuels during the transition period than the Energy Grants (Cleaner Fuel) Scheme grants. Option 4 maintains current arrangements and therefore will not reduce compliance costs.

Gaseous fuels

2.56 Gaseous fuels are currently outside the fuel tax system. In order to tax gaseous fuels, an appropriate taxing point needs to be determined. Both Options 1, 2 and 3 consider that the appropriate point is the marketer or supplier. The marketer or supplier is in a better position to know if the fuel is to be used in a combustion engine or for another (untaxed) use. This approach minimises the compliance costs in distinguishing between taxed and untaxed fuels.

2.57 Under Options 1, 2 and 3, the introduction of excise on gaseous fuels will require the relevant entity to be subject to the provisions of the excise system. As this is likely to increase compliance costs for gaseous fuel distributors, the costs may be reduced through simplification of excise requirements for these producers and marketers, through specific excise reform. This may include allowing payment of fuel tax on a Business Activity Statement.

2.58 To further address compliance costs concerns, industry has been closely consulted on implementation.

2.59 Option 4 does not increase compliance costs for gaseous fuel users as it maintains the status quo.

Users

2.60 Consumers will face no change in compliance costs as a result of any of the options.

2.61 Taxis and other sectors that are dependent on LPG are unlikely to face increased compliance costs as they will not be required to enter the excise system.

2.62 Buses and heavy transport that use gaseous fuels will become eligible for fuel tax credits under Options 1, 2 and 3. Fuel tax credits are designed to offset the impact of fuel excise on business inputs. However in the case of buses and heavy transport used on public roads, fuel tax credits are reduced by a road-user charge (currently 22.6 cpl). As the reduction cannot result in a negative number, and as the fuel tax credit entitlement for gaseous fuels will be less than the current road-user charge, alternative fuel users will pay a lower road-user charge than petrol or diesel users. The different rates may create some complexity for

industry, particularly if fleets are using multiple fuels. As part of the legislative process, they have been consulted on how best to manage this interaction.

Environmental implications

2.63 A carbon price, if implemented, will increase the price of high carbon emission activities relative to low carbon emission activities. To the extent that alternative fuels emit lower amounts of carbon than other fuels, alternative fuels will have a price advantage acting to encourage the use of low emission fuels.

2.64 The application of tax to alternative fuels is consistent with capturing the emissions-based environmental advantages of the alternative fuels through any future carbon price mechanism. Options 1 and 2 will reduce the degree of distortion by limiting the tax advantage offered to alternative fuels. Option 3 will not distort the price signals generated by a carbon price.

Compliance costs

2.65 Overall compliance costs for Options 1, 2 and 3 are medium. The total potential cost of the regulation principally relates to once off transitional compliance costs upon implementation of the options.

Conclusion and recommended option

2.66 Option 2 is the best option to achieve the five key objectives of improving the operation of the fuel market, improving the effectiveness of fuel tax as a proxy for road-user charging, providing certainty to industry and allowing sufficient time to implement the fuel tax changes while providing support to the alternative fuels industry in recognition of the environmental, fuel security and regional benefits that these industries can generate.

2.67 Options 1, 2, and 3 all recommend a review at the completion of the phase-in period to allow the policy's effectiveness to be addressed against the recommendations from the Australia's Future Tax System Review, the outcomes of the tax forum to be held in 2011, the interaction with the proposed carbon price and broader energy issues. Options 1, 2 and 3 allow for consultation with industry on the details of implementing the measure to ensure compliance costs are minimised. Compliance costs are medium for Options 1, 2 and 3.

2.68 Options 1, 2 and 3 may result in a small price change for consumers, while some businesses will have the cost of the tax offset to the extent of their eligibility for fuel tax credits. The higher tax rates will be phased in, minimising any disruption to consumers or producers from any price impacts.

2.69 Option 2 explicitly recognises the environmental, energy security and regional development benefits that can flow from the use of ethanol through addressing the adverse economic implications for the domestic industry of a sudden cessation of the tax-based price advantage over imports. Option 2 smooths the change in the tax advantage over a longer transition period so that the ethanol industry is best placed to adjust to the new tax framework. Under Option 2, excise and excise-equivalent customs duty only apply to LPG Autogas. All other LPG for other uses is subject to an automatic remission of excise and excise-equivalent customs duty. This approach benefits LPG marketers and distributors by lowering business compliance costs, compared to a model in which duty is levied on all LPG, and fuel tax credits are provided to ensure that ultimately only LPG Autogas is effectively taxed. The approach ensures that no compliance costs are imposed on the distribution of LPG that is not for a transport use, thereby benefiting consumers of LPG including householder users of LPG such as for home heating and cooking and bottled gas for barbeques and business use of LPG for commercial purposes (other than transport use).

2.70 Option 3 achieves the objectives of improving the operation of the fuel market and improving the effectiveness of fuel tax as a proxy for road-user charging to a higher degree than Options 1 and 2. Also, Option 3 does not distort the price signals that can be delivered through a carbon pricing mechanism. However, it does not meet the objective of supporting the alternative fuel industry. It could also create uncertainty in the industry as it delivers different policy outcomes than those the industry has been expecting since the 2004-05 Budget.

2.71 Option 4 will result in no price impacts and no change to compliance costs.

Consultation

2.72 Following an announcement in the 2010-11 Budget, consultation with industry and relevant agencies was undertaken to ensure the effective and efficient application of the new tax arrangements. In particular, consultation has established mechanisms that will ensure compliance costs for industry are minimised.

2.73 A discussion paper was released on Treasury's website with invitations for submissions. Written submissions on the policy were received from 47 stakeholders. Twelve submissions were received on the exposure draft legislation. A number of submissions also included more detailed implementation information.

2.74 Treasury held meetings on the discussion paper with stakeholders in five capital cities during the week commencing 25 October 2010. Separate sessions were held for: biodiesel, ethanol and methanol; and gaseous fuels (LPG, LNG and CNG). Further consultation was carried out on the exposure draft legislation in Sydney and Melbourne on 31 January 2011 and 1 February 2011 respectively.

2.75 The key issues that were raised during the consultation period were:

- the tax policy for the alternative fuels should not be developed in isolation to broader energy policy for alternative fuels. There was concern that the changes are not part of a broader government energy strategy to encourage emerging fuels such as CNG and LNG and do not address future transport applications such as electrically powered cars;
- the broader road transport recommendations from the Australia's Future Tax System are not reflected in Government policy;
- the excise rate does not take into account carbon emissions of the various fuels;
- concern about favourable treatment for some fuels that does not apply to other fuels, particularly the ethanol concessions but also electricity (which is not included in the fuels to be taxed). Domestic biodiesel producers have sought similar treatment to ethanol producers;
- ethanol and biodiesel producers are concerned about imports and the impact they will have on the domestic industry;
- the changes are likely to bring many gaseous fuel distributors into the fuel tax system and accordingly submissions suggested that significant compliance cost savings could be achieved for marketers and distributors of LPG by extending the automatic remission model for duty to LPG under which

duty is only applied to LPG Autogas and other LPG is sold free from excise or excise-equivalent customs duty;

- there is only limited transport use of LNG, CNG and methanol in Australia and the industry is concerned that, as it is at the very early stages of commercialisation, the tax changes will prevent them from developing; and
- there is only limited time for businesses to implement the tax changes. While the changes were first announced a number of years ago, the start date is near, and the industry argues that it will not have certainty until Royal Assent.

2.76 As a result of consultations, several changes were incorporated into the draft legislation:

- The excise and excise-equivalent customs duty rates for all alternative fuels (except ethanol and renewable diesel) will be set using net excise rates and not phased down using the Energy Grants (Cleaner Fuels) Scheme.
- There will also be carve outs for CNG for home refuelling systems and for forklifts (or like vehicles which are not used on-road) so that these will not be taxed.
- An automatic remission of excise and excise-equivalent customs duty will be available for non-transport use of LPG and LNG.
- The appropriate unit of measurement for the gaseous fuels is in cpl for LPG and cents per kilogram for LNG and CNG.
- The draft legislation widens the definition for 'ethanol' to incorporate future feedstocks and technologies.
- The existing taxation point will apply for renewable diesel for both excise and excise-equivalent customs duty purposes.
- A rebate of excise duty and excise-equivalent customs duty will apply for the production of renewable diesel.

2.77 The start date of the policy was delayed until 1 December 2011, to allow industry further time to implement systems to deal with the new taxation arrangements.

Implementation and review

2.78 During the consultation process draft legislation was prepared for introduction in time for Royal Assent of the legislation by 1 December 2011. The Australian Tax Office and the Australian Customs and Border Protection Service will prepare to administer the law from 1 December 2011.

2.79 It is recommended that a review of the assistance to alternative fuels be undertaken after 1 July 2015. This review will examine the taxation-based assistance measures in light of the outcomes of the taxation measures themselves, broader energy issues, implementation of a price on carbon and with reference to any recommendations of the Australia's Future Tax System Review, and the outcomes of the tax forum to be held in 2011.

Table 2.1: Option 1 — Relative fuel tax rates for alternative fuels under the previously announced measures (assuming a full fuel excise rate of 38.143 cpl)

<i>Fuel type</i>	<i>Energy Content Band</i>	<i>1 July 2010</i>	<i>1 Dec 2011</i>	<i>1 July 2012</i>	<i>1 July 2013</i>	<i>1 July 2014</i>	<i>1 July 2015</i>
Petrol cpl	High	38.1	38.1	38.1	38.1	38.1	38.1
Diesel cpl	High	38.1	38.1	38.1	38.1	38.1	38.1
Biodiesel cpl	High	0	3.8	7.6	11.4	15.3	19.1
Renewable diesel cpl	High	0	3.8	7.6	11.4	15.3	19.1
Domestic ethanol cpl	Mid	0	2.5	5.0	7.5	10.0	12.5
Imported ethanol cpl	Mid	38.1	2.5	5.0	7.5	10.0	12.5
LPG cpl	Mid	nil	2.5	5.0	7.5	10.0	12.5
LNG cpl	Mid	nil	2.5	5.0	7.5	10.0	12.5
Methanol cpl	Low	nil	1.7	3.4	5.1	6.8	8.5
CNG cpm ³	Other	nil	3.8	7.6	11.4	15.3	19.0

Notes: Rates rounded to 1 decimal place; cpl (cents per litre); cpm³ (cents per cubic metre); 'nil' rates for LPG, LNG, methanol and CNG are for years where these fuels are not in the fuel tax system.

The excise rates listed in Table 2.1 are the 'effective' excise rate. That is these listed rates represent the netting of the actual excise rate and the decreasing offsetting grants to reflect the effective rate each year over the transition period to the full rate.

Table 2.2: Option 2 — Fuel tax rates for domestic and imported ethanol and for natural gas (other rates as per Option 1)

	<i>1 July 2010</i>	<i>1 Dec 2011</i>	<i>1 July 2012</i>	<i>1 July 2013</i>	<i>1 July 2014</i>
Ethanol — legislated tax rate* cpl	38.1	25	21.87	18.74	15.61
Domestic grant cpl	38.1	23.75	19.4	15.05	10.6
Domestic ethanol — effective tax rate cpl	0	1.25	2.5	3.75	5
LNG and CNG cpkg	0	5.22	10.45	16.67	20.9

	<i>1 July 2015</i>	<i>1 July 2016</i>	<i>1 July 2017</i>	<i>1 July 2018</i>	<i>1 July 2019</i>	<i>1 July 2020</i>
Ethanol — legislated tax rate* cpl	12.5	12.5	12.5	12.5	12.5	12.5
Domestic grant cpl	6.25	5	3.75	2.5	1.25	0
Domestic ethanol — effective tax rate cpl	6.25	7.5	8.75	10	11.25	12.5
LNG and CNG cpkg	26.13	26.13	26.13	26.13	26.13	26.13

* This is the excise payable by imported ethanol.

Option 3: Full taxation of alternative fuels

2.80 There are two phases to this option: phase one is identical to Option 1; in phase two, full energy content based fuel tax is phased in by even steps from 1 July 2016 until 1 July 2020 through changes to legislated fuel tax rates.

Table 2.3: Phase 1 — Relative fuel tax rates for alternative fuels under the previously announced measures (assuming a full fuel excise rate of 38.143 cpl)

<i>Fuel type</i>	<i>Energy Content Band</i>	<i>1 July 2010</i>	<i>1 July 2011</i>	<i>1 July 2012</i>	<i>1 July 2013</i>	<i>1 July 2014</i>	<i>1 July 2015</i>
Petrol cpl	High	38.1	38.1	38.1	38.1	38.1	38.1
Diesel cpl	High	38.1	38.1	38.1	38.1	38.1	38.1
Biodiesel cpl	High	0	3.8	7.6	11.4	15.3	19.1
Renewable diesel cpl	High	0	3.8	7.6	11.4	15.3	19.1
Domestic Ethanol cpl	Mid	0	2.5	5.0	7.5	10.0	12.5
Imported Ethanol cpl	Mid	38.1	2.5	5.0	7.5	10.0	12.5
LPG cpl	Mid	nil	2.5	5.0	7.5	10.0	12.5
LNG cpl	Mid	nil	2.5	5.0	7.5	10.0	12.5
Methanol cpl	Low	nil	1.7	3.4	5.1	6.8	8.5
CNG cpm ³	Other	nil	3.8	7.6	11.4	15.3	19.0

Table 2.4: Phase 2 — changes to legislated fuel tax rates

<i>Fuel type</i>	<i>Energy Content Band</i>	<i>1 July 2016</i>	<i>1 July 2017</i>	<i>1 July 2018</i>	<i>1 July 2019</i>	<i>1 July 2020 (final rate)</i>
Petrol cpl	High	38.1	38.1	38.1	38.1	38.1
Diesel cpl	High	38.1	38.1	38.1	38.1	38.1
Biodiesel cpl	High	22.9	26.7	30.5	34.3	38.1
Renewable diesel cpl	High	22.9	26.7	30.5	34.3	38.1
Domestic Ethanol cpl	Mid	15.0	17.5	20.0	22.5	25.0

<i>Fuel type</i>	<i>Energy Content Band</i>	<i>1 July 2016</i>	<i>1 July 2017</i>	<i>1 July 2018</i>	<i>1 July 2019</i>	<i>1 July 2020 (final rate)</i>
Imported Ethanol cpl	Mid	15.0	17.5	20.0	22.5	25.0
LPG cpl	Mid	15.0	17.5	20.0	22.5	25.0
LNG cpl	Mid	15.0	17.5	20.0	22.5	25.0
Methanol cpl	Low	10.3	12.0	13.7	15.4	17.1

Notes: Rates rounded to 1 decimal place; cpl (cents per litre); cpm³ (cents per cubic metre); 'nil' rates for LPG, LNG, methanol and CNG are for years where these fuels are not in the fuel tax system.

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