

**EXPLANATORY MEMORANDUM TO THE
BIOFUELS AND OTHER FUEL SUBSTITUTES (PAYMENT OF EXCISE DUTIES
ETC.) REGULATIONS**

2004 No. 2065

1. 1.1 This explanatory memorandum has been prepared by HM Customs and Excise and is laid before Parliament by Command of Her Majesty.

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

2. Description

2.1 This instrument regulates the production, warehousing and payment of excise duty in respect of several “biofuels”. It consolidates and replaces existing regulations on biodiesel, bioblend and other fuel substitutes, makes similar provision in respect of bioethanol and bioethanol blend, and introduces provisions for the relief from duty of biofuels used in the production of electricity.

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

3.1 For the most part, the powers exercised in this instrument are (as in the instruments it replaces) those found in section 21(1)(a) and (2) of, and paragraphs 3 and 11 of Schedule 3 to, the Hydrocarbon Oil Duties Act 1979 (c. 5) (“the Oil Act”) (“the basic powers”)¹ and section 118A of the Customs and Excise Management Act 1979 (c. 2) (“CEMA”)². The regulations that are not solely an exercise of the basic powers are as follows.

3.1.1 Regulation 3 is made under section 6AC and 6AF of the Oil Act³. In some cases, the powers under the Oil Act that are exercised in this instrument relate to “hydrocarbon oil” or the duty on hydrocarbon oil. The powers exercised under sections 6AC and 6AF enable those other powers to be exercised in respect of biodiesel, bioblend (see section 6AC(1)(a), (b), (2) and (4)), bioethanol and bioethanol blend (see section 6AF(1)(a),(b), (2) and (4)).

3.1.2 Regulation 5 is made under the powers set out in section 127A(1), (2) and (4) of CEMA⁴.

3.1.3 Regulation 7 is an exercise of the basic powers, and sections 93(1)(a) - (c), (2)(a) and (3), 100G(1) and 100H(1)(b) and (2) of CEMA⁵.

¹ Section 21 was amended by Part I (4) of Schedule 23 to the Finance Act 1993 (c. 34). Paragraph 11 of Schedule 3 was amended by paragraph 4 of Schedule 4 to the Finance Act 1985 (c. 54).

² Section 118A was inserted by Schedule 5 to the Finance Act 1991 (c. 31).

³ Section 6AC was inserted by section 5(4) of the Finance Act 2002 (c. 23). Section 6AF was inserted by section 10(3) of the Finance Act 2004 (c. 12).

⁴ Section 127A was inserted by section 6 of the Finance Act 1983 (c. 28) and amended by paragraph 7 of Schedule 1 to the Finance (No 2) Act 1992 (c. 48).

⁵ Section 20AA was inserted by section 2 of the Finance Act 1989 (c. 26) and amended by Part 1(4) of the Finance Act 1993 (c. 34), paragraph 54 of Schedule 4 to the Finance Act 1994 (c. 9) and section 10(3) of the Finance Act 2002.

3.1.4 Regulation 9 is an exercise of the basic powers as well as of section 24(1) of, and paragraph 17 of Schedule 4 to, the Oil Act⁷.

3.1.5 Regulations 10 and 11 are an exercise of the basic powers as well as of section 24(1) of, and paragraph 21 of Schedule 4 to, the Oil Act.

3.1.6 Regulations 13 and 14, and the Schedule, are an exercise of section 118A(1) and (2) of CEMA.

3.1.7 Regulations 17 and 18 are an exercise of sections 1(1), (3), 4(a) and 6(a) of the Finance (No. 2) Act 1992 (c. 48).

3.1.8 Part 7 is an exercise of section 20AA(1)(a) and (2)(a), (b), (c), (d), (g), (h) and (i) of the Oil Act.

3.1.9 Regulation 28 is an exercise of section 24(1) of, and paragraph 3 of Schedule 4 to, the Oil Act⁸.

4. Legislative Background

4.1 Section 6A of the Oil Act⁹ provides for a duty of excise to be charged on certain uses of certain liquids (“fuel substitutes”) that are not hydrocarbon oil. The chargeable uses are, in effect, uses as motor fuel. The precise rates of duty depend on the precise use to which the liquid is put (i.e. what kind of engine), and what hydrocarbon oil it might sensibly be said to be an additive or extender to, or a substitute for. Those rates are specified by Treasury Order¹⁰ (“the Principal Order”). The Principal Order is amended by the Other Fuel Substitutes (Rates of Excise Duty etc.) (Amendment) Order 2004 (“the Amending Order”) with effect from the 1st September 2004, which is laid with this instrument.

4.2 The Other Fuel Substitutes (Payment of Excise Duty etc.) Regulations 1995¹¹ (“the 1995 Regulations”) regulate the administration and collection of the excise duty charged on fuel substitutes, and impose certain requirements on “producers” of fuel substitutes (that is, in short, persons liable to pay such duty) such as the requirement to “make entry” of their premises, keep certain records, issue delivery notes containing certain information and fill in monthly returns and pay the duty due.

4.3 In 2002, section 5 of, and Schedule 2 to, the Finance Act 2002 (c. 23) introduced a separate rate of duty for “biodiesel”, which was formerly charged to duty under section 6A of the Oil Act as a fuel substitute. After the amendments made by section 5 of, and Schedule 2 to, the Finance Act 2002 biodiesel is charged to duty under

⁶ Section 93(1) and (3) were amended by paragraph 2 of Schedule 2 to the Finance (No 2) Act 1992 (c. 35). Sections 100G and 100H were inserted by Schedule 4 to the Finance Act 1991 (c. 31). Amendments not relevant to these Regulations have been made to section 100H.

⁷ Amendments not relevant to these Regulations have been made to section 24(1).

⁸ Paragraph 3 of Schedule 4 was substituted by section 6(3) of the Finance Act 1981 (c. 35) and relevant amendment was made by paragraph 4(2) of Schedule 2 to the Finance Act 2002.

⁹ Section 6A was added by section 11(1) of the Finance Act 1993 (c. 34) and amended by section 11 of the Finance Act 2000 (c. 17), section 7(1) of, and paragraph 2 of Schedule 2 to, the Finance Act 2002 (c. 23) and section 12 of the Finance Act.

¹⁰ S.I. 1995/2716, amended by S.I. 2002/3042 and S.I. 2004/2062.

¹¹ S.I. 1995/2717

section 6AA of the Oil Act and Bioblend is charged to duty under section 6AB of that Act. Other types of substitute for diesel fuel continue to be charged to duty under section 6A. The 1995 Regulations apply in relation to such substitutes.

4.4 The Biodiesel and Bioblend Regulations 2002 (S.I. 2002/1928) regulate the administration and collection of the excise duty charged on biodiesel by section 6AA(1) of the Oil Act, make provision in respect of bioblend charged to excise duty under section 6AB of the Oil Act and make consequential amendments to the 1995 Regulations. The Biodiesel and Bioblend Regulations 2002 were intended to replicate the existing structure and provisions of the 1995 Regulations, with relevant modifications.

4.5 Section 10 of the Finance Act 2004 (c. 12) introduces a new, lower rate of duty in respect of bioethanol. Formerly bioethanol was a fuel substitute. Section 10 of the Finance Act 2004 comes into force on 1st January 2005.

4.6 This instrument consolidates, with minor amendments, the provisions contained in the 1995 Regulations and the Biodiesel and Bioblend Regulations 2002. Those Regulations are revoked. It creates a unified system for the administration, collection and machinery of all “biofuels”. The provisions from regulation 5 onwards will not apply in relation to bioethanol until section 10 of the Finance Act 2004 comes into force. However, the unified machinery structure is put into effect now, at the same time as other changes to the Oil Act.

4.7 The provisions that deal with bioethanol and bioethanol blend are the first exercise of the powers under section 6AF of the Oil Act¹².

4.8 Council Directive 2003/96/EC¹³ (of 27th October 2003 restructuring the Community framework for the taxation of energy products and electricity, commonly known as “the Energy Products Directive” or “EPD”) revoked and replaced two previous directives that harmonised the structures of excise duties on mineral oils and other products that might be substitutes for them. Most of the provisions in the EPD relating to motor and heating fuels were already implemented in UK law by the Oil Act (and legislation made under the Oil Act) and by UK legislation that provides for the climate change levy. The main change was that Article 20 of the EPD brings several new energy products within the existing duty suspension arrangements and allows the duty-suspended free movement of these products within the Community.

4.9 Article 2(3) of the EPD requires fuel substitutes, additives and extenders to be taxed at the rate for the equivalent motor fuel. Section 6A of the Oil Act and the Principal Order (as amended) give effect to this. Bioethanol is also covered by article 2(3), but from 1st January 2005 the UK has taken advantage of the flexibility permitted by Article 16(1) of the EPD to provide for a reduced rate for bioethanol. From 1st January 2005, sections 6AD to 6AF of the Oil Act (not section 6A and the Principal Order (as amended)) will give effect to the second sentence of Article 2(3) of the EPD in respect of bioethanol that is a motor fuel substitute, additive or extender.

4.10 Article 2(2) of the EPD requires biodiesel to be taxed at the rate for the equivalent motor fuel. Again, the UK has taken advantage of the flexibility permitted

¹² Inserted by section 10 of the Finance Act 2004 (c. 12).

¹³ OJ No L 283, 31.10.2003, p 51

by Article 16(1) of the EPD to provide for a reduced rate for biodiesel (for which, see sections 6AA to 6AC of the Oil Act).

4.11 Within the UK, while no change to domestic duty rates was necessary to implement the EPD, legislative changes to accommodate the movement in duty suspension of some energy products not previously covered by duty suspension arrangements were necessary, and the additional powers for the Commissioners in this regard were included in section 13 of the Finance Act 2004 (c. 12). Those powers are exercised in the Excise Warehousing (Energy Products) Regulations 2004 (S.I. 2004/2064), which come into force 1st September 2004 and are laid together with this instrument.

4.12 Biodiesel is a product that must now be part of the Community-wide duty suspended movements system. Some of the fuels substitutes are also brought within this system. Bioethanol and some of the fuel substitutes remain outside the system. Whilst this instrument provides for the collection and administrative arrangements for fuel substitutes, biodiesel and bioethanol, some limited provision has been necessary to deal with the interface between the basic system of production and control for the substances and the new warehousing arrangements. In this respect, this instrument goes further than simply consolidating the previous legislation.

4.13 Part 7 of this instrument makes new provision, providing for a new relief for biofuels used to generate electricity. This gives effect to the first sentence of Article 14(1)(a) of the EPD. No specific undertakings were given to Parliament, either in the form of a Parliamentary question or Committee appearance in relation to Part 7 of these Regulations.

4.14 A transposition note for the EPD can be found in the annex to this memorandum. The EPD was considered by the House of Commons European Scrutiny Committee on 27 November 2002¹⁴ and cleared by sub-Committee A of the House of Lords Select Committee on the European Union by letter dated 5 December 2002 to Dawn Primarolo, Paymaster General, HM Treasury¹⁵.

5. Extent

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 Not Applicable

7. Policy Background

7.1 As set out in Section 4 above, the Finance Act 2004 introduced a specification and duty rate for bioethanol and bioethanol blend (a blend of bioethanol and petrol) intended for use as motor or heating fuel. These Regulations consolidate the previous provisions and regulate the administration and collection of that excise duty. They incorporate the rules in one set of regulations, which cover all biofuels, and fuel substitutes, and revoke the existing, separate Regulations. Wherever possible the

¹⁴ 2nd Report of Session 2002-03, HC 63-ii.

¹⁵ Progress of Scrutiny, First Report for Session 2002-03, 9 December 2002, ISBN 010 490192 6.

requirements are merged so that, for instance a producer of both biodiesel and bioethanol needs to complete only one return of duty (rather than two) and submit his payment in respect of both fuels at the same time.

7.2 Although the introduction of the specification and duty charge for bioethanol was announced in a Budget 2004 Notice, it has not specifically been raised in Parliament, nor has it had any media attention.

7.3 Under current legislation, biofuels and fuel substitutes used to generate electricity through incineration are not subject to excise duty. However, those used to generate electricity using an engine are subject to duty. This is clearly an anomaly: it is inconsistent that liquid biomass used to generate electricity is exempt from duty when burnt in incinerators, but dutiable when burnt in diesel engines. Part 7 of these Regulations provide that biofuels used as motor fuel in a generator to produce electricity will be subject to a relief of the duty that has been charged and paid.

7.4 The current position has meant that using biofuels and fuel substitutes to produce electricity in a diesel engine has been uneconomic. The relief introduced by these Regulations will enable electricity to be produced in this way at a lower cost.

7.5 Although the introduction of the relief was announced in a Budget 2004 Notice, it was not specifically mentioned in Parliament, nor has it had any media attention.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument, as it has no impact on business, charities or voluntary bodies.

8.2 The impact on the public sector is nil.

9. Contact

9.1 Tim Smith, in the Environmental Taxation Development Division, HM Customs and Excise, 1st Floor West, New King's Beam House Tel: 020 7865 5600 or email: timothy.smith@hmce.gsi.gov.uk can answer any queries regarding Part 7 of this instrument.

9.2 Geoff Riley, in the Oils Team, Excise Group, HM Customs and Excise, 3rd Floor West, Ralli Quays Tel: 0161 827 0128 or email: geoff.riley@hmce.gsi.gov.uk can answer any queries regarding all other parts of the instrument.

ANNEX

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

Articles	Objectives	Implementation	Responsibility
1	Member states to impose taxation on energy products in accordance with this Directive	<p>This Directive replaces and repeals two earlier Council Directives and gives a unified framework to the treatment of motor and heating fuels. Many of the articles in this Directive are therefore already enacted in UK legislation. Where this is the case this transposition note records that no action is necessary. The Directive brings several new energy products within existing duty suspension arrangements and allows the duty suspended free movement of these products within the EU.</p> <p>No change to the scope of UK legislation, or rates of duties, was necessary to implement the EPD.</p> <p>The Directive introduces new energy products –biodiesel, animal and vegetable fats and methanol intended for use as motor or heating fuel – into duty suspension arrangements. Section 13 of the Finance Act 2004 inserted a new section on warehousing into the Hydrocarbon Oil Duties Act 1979 (the “Oil Act”), allowing the application of duty suspension arrangements to a range of new energy products.</p> <p>These regulations – “The Biofuels and Other Fuel Substitutes (Payment of Excise Duties etc.) Regulations 2004” and “The Excise Warehousing (Energy Products) Regulations 2004” – referred to in this document as “The Regulations”, which will come into force on 1 September 2004, regulate the administration and collection of the excise duty charged on biofuels and other fuel substitutes and provide the means for warehousing the new energy products.</p>	Economic Secretary to the Treasury – through new regulations.

Articles	Objectives	Implementation	Responsibility
2	Lists the products to which the Directive applies and provides conditions under which those products are taxed. Also lists products and uses of those products that the Directive does not apply to.	<p>Existing UK legislation covers a wide range of these products and their taxable uses, divided between Climate Change Levy and Excise Duties on motor and heating fuels (both administered by Customs and Excise). The changes to UK legislation necessary to fully implement the Directive were limited to the inclusion of new energy products in duty suspension arrangements.</p> <p>Section 13 of Finance Act 2004 incorporated changes to the Oil Act bringing the new energy products into duty suspension arrangements.</p> <p>The Regulations provide the conditions under which these products may be warehoused and charged with duty.</p>	<p>As above</p> <p>Policy Responsibility is with Oils Team, Tax Practice, HM Customs & Excise, Ralli Quays, Salford.</p>
2(3)	Ensures that the UK's taxation of energy products in respect of motor fuel substitutes, additives and extenders (other than biodiesel) complies with Community framework for taxation of energy products.	Section 6A of the Oil Act (and the Other Fuel Substitutes (Rates of Excise Duty Etc.) Order 1995, which is most recently amended by the Other Fuel Substitutes (Rates of Excise Duty Etc.) (Amendment) Order 2004) ensure that taxation of these products complies with the Energy Products Directive.	<p>Economic Secretary to the Treasury – through new regulations.</p> <p>Policy responsibility is with Environmental Taxation Development Division, Policy Group, HM Customs & Excise, New Kings Beam House, London</p>
3	Definitions	No action necessary	
4	Minimum levels of Taxation	No action necessary	
5	Differentiated levels of taxation allowed in particular circumstances	No action necessary	
6	Defines how exemptions and reductions may be given	No action necessary	
7	Implementation dates for minimum levels of taxation with particular reference to gas oil, public transport and road user charges	No action necessary	

Articles	Objectives	Implementation	Responsibility
8	Minimum levels of taxation appropriate to various industrial and commercial purposes such as agriculture and stationary motors	No action necessary	
9	Minimum taxation levels for heating fuel	No action necessary	
10	Minimum levels of taxation applicable to electricity	No action necessary	
11	Definition of “business use”	No action necessary	
12	Units of measurement	No action necessary	
13	Value of Euro in determining levels of taxation	No action necessary	
14	Range of exemptions	See below	
14(1)(a)	To exempt from taxation energy products used to produce electricity.	Part 7 of the Biofuels and Other Fuel Substitutes (Payment of Excise Duties etc.) Regulations 2004 provides relief for biofuels used as motor fuel in a generator to produce electricity.	Economic Secretary to the Treasury – through new regulations. Policy responsibility is with Environmental Taxation Development Division, Policy Group, HM Customs & Excise, New Kings Beam House, London
15	Range of exemptions allowable for particular purposes	No action necessary	
16	Range of exemptions and reduced tax rates for certain energy products, including products produced from biomass. Includes requirement for member states to inform the Commission of tax reductions and exemptions applied	No action necessary.	
17	Reduced levels of taxation for heating purposes	No action necessary	
18	Derogations – including expiry of certain derogations on 31 December 2006	No action necessary	
19	Commission powers to grant or revoke derogations	No action necessary	

Articles	Objectives	Implementation	Responsibility
20	Provides for which energy products are to be subject to duty suspension arrangements under Directive 92/12.	Section 13 of Finance Act 2004 incorporated changes to the Oil Act to enable the new energy products to be brought into existing duty suspension arrangements. The Regulations provide the conditions under which these products may be warehoused and charged with duty.	Economic Secretary to the Treasury – through new regulations. Policy Responsibility is with Oils Team, Tax Practice, HM Customs & Excise, Ralli Quays, Salford.
21	Provides for circumstances and events when duty charge is applicable	No action necessary	
22	Allows for tax increases to apply to energy products held in stock	No action necessary	
23	Allows for refunds on contaminated products sent back for recycling	No action necessary	
24	Prevents dual taxation of fuel used for transport between member states	No action necessary	
25	Requirement for annual report of levels of taxation on energy products	No action necessary	
26	Requirement to inform the Commission of measures taken in respect of Articles 5, 14(2), 15 and 17	No action necessary	
27	References to Decision 199/468/EC and adoption of Rules of Procedure	No action necessary	

Articles	Objectives	Implementation	Responsibility
28	Time limits for compliance with this Directive	<p>The Energy Products Directive, 2003/96, came into force on 1 January 2004.</p> <p>The UK legislative timetable has meant that new provisions necessitated by the Directive were presented in the Finance Bill delivered by the Chancellor of the Exchequer to Parliament on 17 March 2004.</p> <p>Existing UK legislation already deals with the taxation of products used, or intended to be used, as motor or heating fuels. No changes to UK legislation were necessary to alter any charging provisions. However, changes were necessary to include the new energy products described in the Directive, in arrangements, to facilitate the duty suspended free circulation of these products.</p> <p>The Commission was aware that member States were unlikely to be able to implement the provisions of the Directive on time because of its late passage through the European Parliament (it was adopted on 27th October 2003 only a few months before it comes into effect).</p> <p>However, a letter of formal notice of infringement has been received. The Commission has been informed of the legislative process that the UK has undertaken and the Regulations accompanying this document fulfil the UK's obligations under the Directive.</p>	
29	Periodic examination of exemptions and minimum levels of taxation	No action necessary	
30	Repeal of Directives 92/81 and 92/82	Reference to these Directives in UK legislation has been changed by section 14 of the Finance Act 2004.	<p>Economic Secretary to the Treasury</p> <p>Policy Responsibility is with Oils Team, Tax Practice, HM Customs & Excise, Ralli Quays, Salford.</p>

Articles	Objectives	Implementation	Responsibility
31	Date of entering into force	See comments at Article 28	
32	Directive addressed to Member States		
Annex I	Minimum levels of taxation applicable to motor fuels	No action necessary	
Annex II	Reduced rates and exemptions from taxation applicable to member states.	No action necessary	