

REVIEW OF THE DEFINITION OF BIODIESEL IN HYDROCARBON OIL DUTIES ACT 1979: SUMMARY OF RESPONSES AND FINDINGS

Background

Budget 2006 announced that the Government would carry out a review of the fiscal definition of biodiesel with a view to considering whether any new fuels should qualify for the reduced rate for biodiesel and whether the current definition remained fit for purpose in terms of the way it dealt with current types of biodiesel, in the light of representations that the definition was too restrictive (for example, in terms of ester content) or that it was not sufficiently restrictive (for example, that it should specifically exclude straight vegetable oil from the scope of the reduced rate).

Summary of responses

In all, 118 responses were received. A breakdown of those responding is given below. Responses came largely from individuals with an interest in the environment. Trade associations that replied covered most of those involved in biodiesel production, as well as the National Farmers' Union, the Country Landowners' Association and the Freight Transport Association. Only one major fuel producer replied, and it supplied details of a new fuel rather than giving specific comments on the existing fiscal definition of biodiesel.

| Status | Numbers |
|---------------------|---------|
| Individuals | 82 |
| Users | 2 |
| Biodiesel producers | 21 |
| Main fuel producers | 1 |
| Trade associations | 12 |

Issues raised in responses

The main issues raised by respondents are summarised below.

1. Whether the fiscal definition should be amended to cover any other fuels

It was recognised that there would be technological changes in the future that would mean that the fiscal definition would have to be reviewed and amended regularly, and most respondents believed that the definition should be as wide as possible. The Government is aware that there are plans for the production of a new second generation biodiesel which would not be covered by the current definition.

Comment:

The Government accepts that technological developments are proceeding apace, and is keen to support second generation biofuels (which may offer greater environmental benefits than existing types of fuel). With this in mind, the fiscal definition of biodiesel will need to be sufficiently flexible and responsive to cater for new fuels, and will therefore be kept under continual review. As a first step, the Government will be considering what changes are needed to accommodate the new fuel referred to by one of the consultation respondents.

Although the requirements of the Renewable Transport Fuel Obligation (RTFO) may lead to a greater emphasis on large scale production of biofuels and second generation fuels, the Government nevertheless wishes to continue to support smaller-scale producers, though it recognises that some current types of biodiesel (and, in particular, those produced largely from straight vegetable oil (SVO)) are likely to remain niche fuels.

2. Whether the current definition was too restrictive or not sufficiently restrictive (for example, should straight vegetable oil be excluded from or included in the definition?)

The table below shows the views of respondents.

| | |
|--------------------------------------|-----|
| Include SVO within fiscal definition | 101 |
| Exclude SVO from fiscal definition | 4 |
| No views on issue | 13 |

The great majority of respondents believed that SVO should be included within the fiscal definition, because:

- There was no scientific evidence to suggest that SVO should be treated differently from other types of biodiesels.
- In some tests, SVO seemed to offer lower carbon emissions than transesterified biodiesel.
- No harmful chemicals such as methanol were used in producing SVO.
- Unlike transesterified biodiesel, SVO gave rise to no unwanted by-products such as glycerol.
- SVO was easier to obtain for local production, and therefore provided a better carbon footprint.
- SVO could be produced easily in rural areas.

Most respondents also thought that the current definition was adequate: the problem had been that local HMRC officers had interpreted it too strictly. Many respondents also said that HMRC needed to ensure that legislation was interpreted consistently in order to be fair to all producers across the UK. HMRC were also criticised by some as acting as unofficial quality controllers by making subjective judgments on the environmental benefits of fuels - something for which they had no remit. However, HMRC's experience has been that many producers had failed to have their fuel tested against the legal definition and had no proof that their fuel qualified for the lower duty rate. HMRC will today publish additional guidance on the definition and more specifically on testing. This guidance has recently been issued to HMRC staff.

On the other hand, only four respondents (of whom two were biodiesel manufacturers who used the transesterification process) suggested that SVO should be excluded from the fiscal definition of biodiesel. They felt that it was unfair that SVO should be classified as biodiesel, since in their view the duty differential for biodiesel had largely been granted to help with the extra costs of production involved in making biodiesel using transesterification. Those using SVO faced no similar costs of production and were in their view also producing sub-standard fuel, given that SVO might contain damaging additives with detrimental environmental effects. This point was also made by a manufacturer of catalytic systems for vehicles, who believed that SVO with certain additives should be penalised with higher duty rates.

One other respondent opposed to inclusion of SVO within the fiscal definition suggested that using biodiesel was an inefficient use of biomass for energy. The respondent advocated restrictions on the sale and use of SVO because he saw it as environmentally damaging.

In addition, DTI and DfT reported some concern within the fuel and vehicle sector about SVO, largely caused by doubts about its effects on engines, although this concern was not supported by firm evidence. Although this was essentially a question of fuel quality, it was suggested that the duty system could be used to differentiate fuels perceived by the sector as lower quality from other types of biodiesel: for example, by establishing a separate fiscal definition (see 5. below).

Comment:

There is no definitive evidence to support excluding SVO from the scope of the fiscal definition. The Government accepts the need for consistent interpretation of the legislation, and, as set out above, HMRC will today publish additional guidance on the definition and more specifically on testing.

3. Whether transesterified biodiesel should be encouraged

Many supporters of SVO questioned the environmental benefits of transesterified biodiesel. They said that transesterification used more carbon and harmful chemicals, and produced unwanted by-products. Some also

called for the methanol used in transesterification to be charged duty at the standard rate of 47.10 pence per litre.

Comment:

The available data confirm that transesterified biodiesel offers carbon savings relative to conventional road fuels, and there is no environmental reason to reconsider how transesterified biodiesel is treated for tax purposes. In addition, EU directives recognise transesterified biodiesel as a biofuel and the Government has no reason to disagree with that assessment.

Methanol for transesterification is used before duty is payable and is only present in trace levels within biodiesel when it does pass the duty point. The Government does not propose to change the existing treatment of methanol.

4. Harmonised duty treatment of biofuels across EU

There were some suggestions that the UK should follow other Member States' practice in its duty treatment of biofuels.

Comment:

In practice, there are a number of differences in how other Member States deal with different biofuels for tax purposes: for example, France pays a rebate for the production of a specified amount of bioethanol by approved suppliers each year; and Germany currently charges no duty on any biofuels. There is no obvious consistency of approach on taxation that the UK could easily follow. The Government believes that tax matters are for national Governments and takes decisions on tax rates based on what is best and most appropriate for the environment and the UK economy. It is useful to learn from practices in other countries but the tax incentives given for biofuels need to reflect the specific balance of UK priorities.

5. Whether SVO should be given its own specific duty rate

As noted under 2. above, there were suggestions that fuels perceived by the fuel and vehicle sector to be of better quality should be encouraged by inclusion within the fiscal definition, while some fuel produced from SVO should be discouraged by exclusion from the definition.

Comment:

Given the lack of definitive evidence on this issue, it would be difficult to present a coherent and convincing case for splitting the definition in this way. It is unclear that it would add any clarity to the issue of what was or was not biodiesel.

In addition, this is essentially a fuel quality issue, and HMRC would have no sanctions on how vendors described their fuel at the point of sale. This

demonstrates the limitations of using the fiscal definition as a means of regulating fuel quality.

6. Fuel additives

The review highlighted that SVO might contain additives to improve performance: for example, by reducing viscosity. Additives may also be used in conventional fuels, and HMRC's current practice is to treat additives as fuel substitutes and charge duty at the equivalent rate for ultra-low sulphur petrol and diesel.

Comment:

Where additives do not meet definitions of biofuels in European legislation (see Directive 2003/30/EC, Article 2), there is no case for charging duty at the biodiesel rate.

7. Prohibition of certain types of biodiesel

Some respondents suggested that biomass used to produce biodiesel could come from sources such as tropical rainforests, and that much palm oil was made from cutting down forests. Biodiesel produced in this way should not be eligible for a duty incentive.

Comment:

It is not the purpose of the fiscal definition to distinguish the source of fuels in this way. It would also be difficult to enforce a definition of this kind. Work is under way, led by the Low Carbon Vehicle Partnership, to develop environmental assurance schemes for biofuels. This is focusing on the issues of carbon benefits and wider environmental sustainability, and reflects the importance the Government attaches to ensuring that biofuels are delivered in a way which maximises life-cycle carbon savings, while ensuring biofuels are sourced sustainably. This work will inform the delivery of the Renewable Transport Fuel Obligation, starting in 2008-09.

8. UK-produced biodiesel

Some respondents suggested that UK-produced biodiesel should also be treated more favourably for tax purposes – for example, to encourage local production and minimise transport costs.

Comment:

EU agreements prohibit giving preferential duty treatment to UK-produced biodiesel.

9. Other fuels

One potential new road fuel was identified that could be produced from oils extracted from waste plastic. It was suggested that this merited inclusion within the scope of the fiscal definition.

Comment:

This fuel was outside the scope of the review as it was not produced from biomass. The Government recognises, however, that non-biomass alternative fuels may also offer environmental benefits, and will assess the case for supporting such fuels. .

Conclusions

- The Government is keen to support second generation biofuels and keep abreast of technological developments, and will keep the fiscal definition of biodiesel under continual review to ensure that it is sufficiently flexible and responsive to cater for new fuels.
- As a first step, the Government will be considering what changes to the definition are needed to accommodate the new second generation biodiesel for which production plans are in hand.
- The current fiscal definition remains otherwise satisfactory in defining what is and what is not biodiesel.
- There is no definitive evidence to justify excluding SVO from the scope of the fiscal definition.
- Guidance on interpretation of the definition will be revised further to include more information on testing the product against the fiscal definition.
- Steps (such as training and internal publicity) have been taken to ensure that the regulations will be more consistently applied by HMRC staff in line with the revised guidance.

**HM Revenue & Customs
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