Australian Government

The Treasury

31 July, 2009

Senator Mathias Cormann
Chair
Senate Select Committee on Fuel and Energy
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Senator Cormann

Thank you for your letter of 19 June 2009 inviting Treasury to provide a submission to the Senate Select Committee on Fuel and Energy.

Consistent with your request, we have focused our submission on the revised terms of reference and on (f)(i)(ii), the taxation arrangements applicable to fuel and energy products.

Treasury's submission provides an overview of the following issues relating to the taxation of fuel and energy:

1. the main fuel types used for road transport in Australia;
2. the history of fuel taxation in Australia;
3. the upstream petroleum industry – current taxation and royalty arrangements;
4. current fuel taxation arrangements and subsidies applying to petrol and diesel;
5. current fuel taxation arrangements and subsidies applying to biodiesel and ethanol;
6 current fuel taxation arrangements and subsidies applying to liquefied petroleum gas (LPG), liquefied natural gas (LNG) and compressed natural gas (CNG);
7. the impact of the Carbon Pollution Reduction Scheme (CPRS) on fuel; and
8. the Australia's Future Tax System review.

I trust the attached information will be of assistance to the inquiry. Please do not hesitate to contact Glen McCrea on 02 6263 3502 if you have any questions.

Yours sincerely

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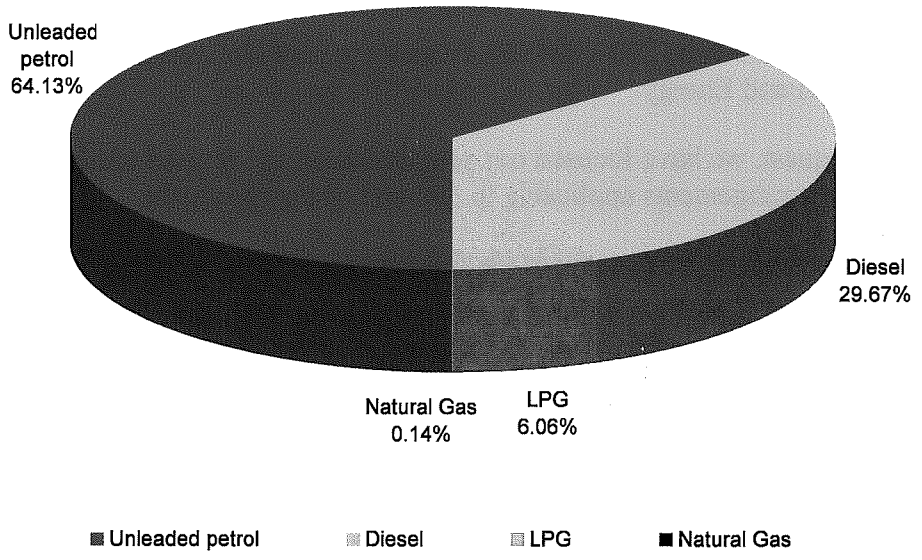
1. MAIN FUEL TYPES USED FOR ROAD TRANSPORT IN AUSTRALIA

The major sources of road transport fuel in Australia (measured by energy content) are unleaded petrol, diesel and liquefied petroleum gas (LPG). Chart 1 shows unleaded petrol accounts for almost two-thirds of all energy used in Australian road transport. Diesel accounts for around 30 per cent, while LPG accounts for just over 6 per cent. Other alternative fuels are a small proportion of the fuel market, these include biodiesel (which accounted for 0.12 per cent of total fuel used in Australian road transport based on Energy in Australia 2008 data), compressed natural gas (CNG) and liquefied natural gas (LNG). The use of natural gas as a road transport fuel is less than 1 per cent.

CHART 1: ENERGY USE IN AUSTRALIAN ROAD TRANSPORT BY FUEL TYPE
Per cent (2006-07)



Source: ABARE, *Energy in Australia 2009*

Biodiesel is typically made from vegetable oils, animal fats (tallow) and used cooking oil. Biodiesel differs slightly from diesel in terms of its energy content, octane rating (linked to engine performance) and other physical properties. Biodiesel is mostly used in mixtures with diesel in proportions of 5 (B5) and 20 (B20) per cent.[1]

Ethanol is a liquid alcohol usually produced through fermentation and distillation from crops rich in sugar. Ethanol is typically used in mixtures with petrol of up to 10 per cent (commonly referred to as E10).[2]

LPG is a mixture of compressed propane and butane ultimately transformed into a gaseous state. LPG is the main alternative to petrol and diesel as a transport fuel.

CNG and LNG are both composed primarily of natural gas, or methane (CH4), which is produced either from gas wells or in conjunction with crude oil production. CNG and LNG have lower

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[1] Department of Resources, Energy and Tourism, *Biodiesel*, http://www.ret.gov.au/resources/fuels/alternative_transport_fuels/Pages/Biodiesel.aspx.

[2] Department of Resources, Energy and Tourism, *Ethanol*, http://www.ret.gov.au/resources/fuels/alternative_transport_fuels/Pages/Biodiesel.aspx.

energy content than either petrol or diesel, however they produce less exhaust emissions and are abundantly available in Australian natural gas reserves.

CNG requires pressurised tanks that are able to withstand automotive environmental exposure. LNG is a cryogenic fuel (extremely cold), and it requires special equipment and handling. Due to this and other practical impediments, CNG and LNG are predominantly used in heavy vehicles such as metropolitan bus fleets, garbage trucks and line haulage.[3]

[3] Department of Resources, Energy and Tourism, *CNG and LNG*, http://www.ret.gov.au/resources/fuels/alternative_transport_fuels/Pages/CNGandLNG.aspx.

2. FUEL TAXATION IN AUSTRALIA

Early history of excise

Since Federation, the Commonwealth has applied excise or excise-equivalent customs duty to petroleum products. Excise is a levy on a domestic stage in the production or distribution of goods and has traditionally been imposed on the manufacture of goods in Australia. In contrast, excise-equivalent customs duty is levied on the importation of goods.

Section 90 of the *Commonwealth of Australia Constitution Act 1900* exclusively restricts the power to levy excise to the Commonwealth. This interpretation is reflected in High Court judgement *Ha and Lim v State of New South Wales & ors; Walter Hammond & Associates v State of New South Wales & ors, High Court of Australia, 5 August 1997, Matter No. S45 of 1996*. Prior to this decision, the States (excluding Queensland) levied certain fees on petroleum products, such as business franchise fees.[4]

Until 1929, Australia relied on imported petroleum products and as such collected revenue solely in the form of customs duty. Excise on domestically produced petrol was introduced in 1929 with the establishment of domestic refineries. The excise revenue collected was hypothecated to funding road construction. Hypothecation continued until 1959 when excise became a form of general revenue.

Various changes to excise rates for petroleum products were implemented over the following decades in response to changing policy imperatives. In particular, excise was extended to diesel and, for a period between 1975 and 1979, to LPG.[5]

More detail on the history of fuel taxation in Australia can be found in the *Fuel Taxation Inquiry Issues Paper* and the *Fuel Taxation Inquiry Report* available at http://fueltaxinquiry.treasury.gov.au/content/welcome.asp.

A New Tax System, 2000 and beyond

More recently, there have been a number of comprehensive reforms to the fuel tax system. In 2000, as part of The New Tax System and introduction of the goods and services tax (GST), the Fuel Sales Grants Scheme was introduced (this scheme ceased application on 1 July 2006). The scheme provided grants of one cent per litre to registered fuel retailers in non-metropolitan zones and two cents per litre in remote zones. The scheme was designed to combat the effects of the GST on the differential between city and country fuel prices.[6]

The Diesel and Alternative Fuels Grants Scheme was also established at this time. The scheme was designed to reduce business transport costs, particularly in rural areas. This scheme complemented the existing Diesel Fuel Rebate Scheme which provided a rebate for certain off-road uses of diesel. The Diesel and Alternative Fuels Grants Scheme grant was paid to users of diesel in on-road applications. All business-related on-road use of diesel in a vehicle over 20 tonnes gross vehicle mass was eligible for the grant. Eligibility for vehicles between 4.5 and 20 tonnes depended on

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[4] The Treasury 2001, *Fuel Taxation Inquiry Issues Paper*, http://fueltaxinquiry.treasury.gov.au/content/issues/fti_internet.pdf.

[5] The Treasury 2001, Fuel Taxation Inquiry, http://fueltaxinquiry.treasury.gov.au/content/backgnd/002.asp.

[6] The Treasury 2002, Fuel Taxation Inquiry report, pages 259-260.

where the journey took place and the type of transport service provided. The grant was also available to alternative fuels to maintain their price relativities to diesel.[7]

From 1 July 2003, both these schemes were incorporated into the Energy Grants (Credits) Scheme which essentially maintained the same entitlements.

The Energy Grants (Cleaner Fuels) Scheme

In 2004 the Energy Grants (Cleaner Fuels) Scheme was introduced to provide a generic framework for the payment of grants for the importation and manufacture of cleaner fuels with the intention to promote their uptake.[8]

In general, the grant amount equals the excise or excise-equivalent customs duty payable on the respective fuels. (As at 1 July 2009, the excise and excise-equivalent customs duty rate applicable to these fuels is 38.143 cents per litre).

The Energy Grants (Cleaner Fuels) Scheme is administered by the Australian Taxation Office. Some $115 million in cleaner fuels grants scheme payments were paid to eligible fuels (such as low sulphur premium unleaded petrol, ultra low sulphur automotive diesel and biodiesel) in the 2007-08 financial year.[9] This was up from $92 million in the 2006-07 year. The increase is attributable to more fuels becoming eligible for the grant, in particular ultra low sulphur automotive diesel.[10]

Fuel Tax Act 2006

The *Fuel Tax Act 2006* introduced fuel tax credits. Fuel tax credits are designed to:

- remove or reduce the incidence of fuel tax from business inputs so that its incidence falls on private consumption;
- provide comprehensive and consistent arrangements for fuel tax relief for business; and
- reduce business compliance costs.[11]

Under the fuel tax credit system, all taxable fuel acquired or manufactured in, or imported into, Australia for use in off-road applications for business purposes will become tax-free over time. Partial fuel tax credits are also provided to taxable fuel acquired or manufactured in, or imported into, Australia for use on-road for all business purposes in registered vehicles with a gross vehicle

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[7] Commonwealth of Australia 1999, *The Diesel and Alternative Fuels Grants Scheme Bill 1999 Explanatory Memorandum*, http://www.austlii.edu.au/au/legis/cth/bill_em/daafgsb1999389/memo1.html.

[8] Commonwealth of Australia 2003, *Energy Grants (Cleaner Fuels) Scheme Bill 2003 Explanatory Memorandum*, page 3.

[9] Low sulphur premium unleaded petrol was eligible for a grant between 1 January 2006 and 31 December 2007, and ultra low sulphur automotive diesel was eligible for a grant between 1 January 2007 and 31 December 2008.

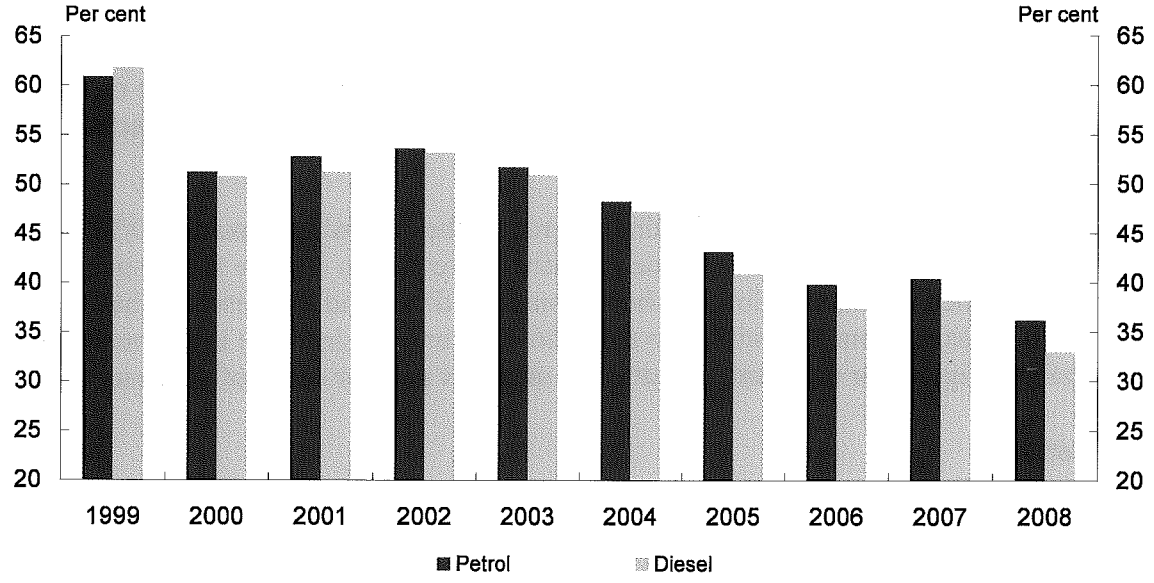
[10] Australian Taxation Office 2008, *Taxation statistics 2006–07 - fuel schemes* http://www.ato.gov.au/content/downloads/00177078_2007CH14EGS.pdf, page 126.

[11] Commonwealth of Australia 2006, *Fuel Tax Bill 2006 Revised Explanatory Memorandum*, page 8.

mass of more than 4.5 tonnes (see section 4: current fuel taxation arrangements applying to petrol and diesel for further information).[12]

In March 2001 the indexation of excise rates on fuel was removed (bi-annual indexation continues to apply to tobacco and alcohol products). The removal of indexation has contributed to a decline in tax collected as a proportion of the retail price of fuel. Chart 2 illustrates that the proportion of tax included in the price of unleaded petrol and diesel has fallen from around 61 per cent of the average price in 1999, to 36 per cent for petrol and 33 per cent for diesel respectively in 2008.

CHART 2: PERCENTAGE OF TAX IN THE RETAIL PRICE OF PETROL AND DIESEL

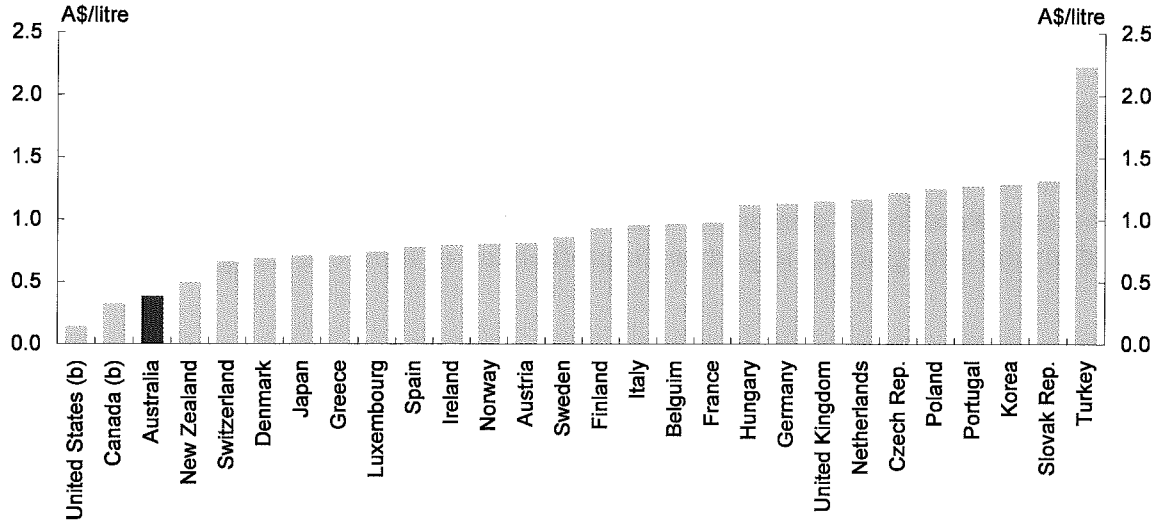


Sources: International Energy Agency, *Energy Prices & Taxes Quarterly Statistics First Quarter 2009* and International Energy Agency, *Energy Prices & Taxes Quarterly Statistics Fourth Quarter 2007*

Australia's excise rate on petrol and diesel is low compared with other OECD countries. Chart 3 shows the nominal excise rates on unleaded petrol in OECD countries as at the first quarter 2009, while Chart 4 shows the nominal excise rates on diesel over the same period (both charts do not include GST for Australia). Where countries levy more than one excise on unleaded petrol and diesel, the total combined rate is shown. As Chart 3 indicates, Australia's excise rate of 38.143 cents per litre is the third-lowest excise rate on unleaded petrol of the OECD-30 countries shown.

[12] Ibid page 3.

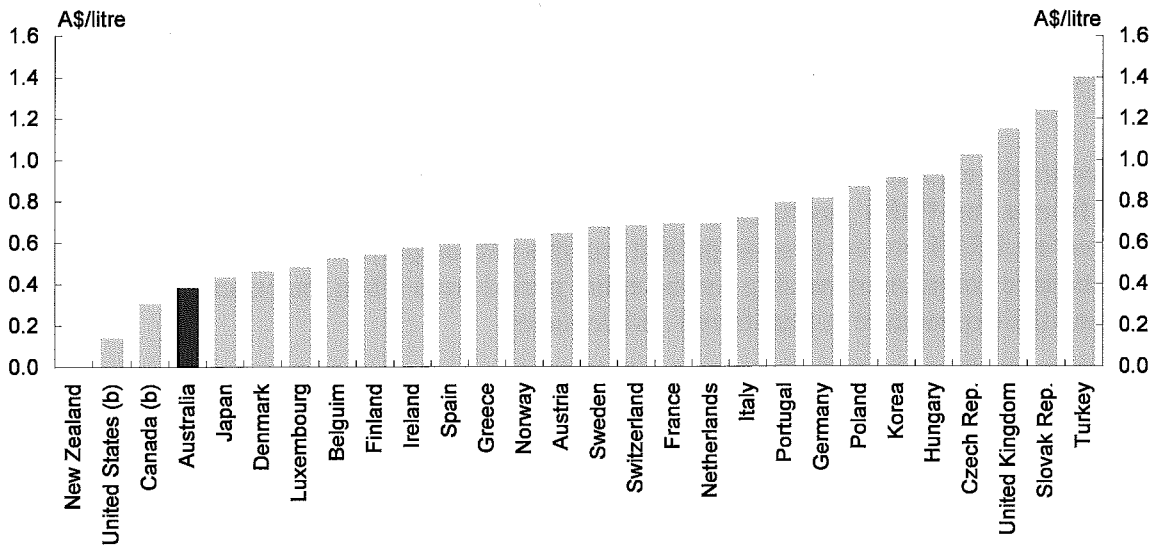
CHART 3: UNLEADED PETROL EXCISE DUTY RATES
OECD-30, as at first quarter 2009[a]



(a) Converted to Australian dollars using OECD Purchasing Power Parities. Mexico levies excise duty on unleaded petrol at an ad valorem rate. Hence, the rate per litre varies according to international petrol prices and is not included in the comparison.
(b) In Canada and the United States, both the federal governments and the state/provincial governments levy taxes on unleaded petrol. An average rate has been calculated for the States and Provinces by the OECD/European Environment Agency, and the combined rates are shown.
Source: Australian Treasury estimates based on OECD and European Environment Agency data.

In addition, Chart 4 indicates Australia's excise rate of 38.143 cents per litre is the fourth-lowest excise rate on diesel of the OECD-30 countries shown.

CHART 4: DIESEL EXCISE DUTY RATES
OECD-30, as at first quarter 2009[a]



(a) Converted to Australian dollars using OECD Purchasing Power Parities. Mexico levies excise duty on unleaded petrol at an ad valorem rate. Hence, the rate per litre varies according to international petrol prices and is not included in the comparison.
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Source: Australian Treasury estimates based on OECD and European Environment Agency data.

3. UPSTREAM PETROLEUM INDUSTRY – CURRENT TAXATION AND ROYALTY ARRANGEMENTS

Overview

The upstream petroleum industry is the business of extracting petroleum resources such as crude oil and natural gas. Various tax and royalty arrangements apply to this industry. The policy rationale for these arrangements is to provide a return to the community for allowing private firms to extract petroleum resources owned by the community while not inhibiting investment in the industry. The various tax and royalty arrangements impact on the profitability of firms extracting petroleum resources.

The following provides a summary of these arrangements, including identifying incentives within these arrangements which encourage petroleum exploration.

Petroleum resource rent tax

The petroleum resource rent tax (PRRT) was introduced with effect from 1 July 1986. It applies to all offshore oil and gas projects except the North-West Shelf project, which is located off the north-west coast of Western Australia. This project is subject to the crude oil excise and other royalty arrangements which are discussed below. The application of the PRRT to offshore areas reflects the fact that Australian Government jurisdiction is limited to offshore areas. The Bass Strait project located off south-eastern Victoria became subject to the PRRT in July 1990. This project was previously subject to the crude oil excise and other royalty arrangements.

The PRRT is a tax on economic rent generated by a petroleum project, with the tax rate set at 40 per cent of taxable profit. The PRRT is assessed on a project basis and the liability to pay PRRT is imposed on each taxpayer in relation to its interest in the project. This liability is based on the project's assessable receipts less project expenditures. Deductible expenditure not offset against project receipts in a financial year is compounded at varying rates (depending on the type of expenditure and time between the expenditure being incurred and deducted) and is available as a deduction against project receipts in future years. Generally, compounding provides the equivalent of full financing cost plus a minimum compound return, and otherwise maintains the real value of expenditure.

The PRRT encourages exploration in offshore areas in two ways. First, exploration expenditure can be transferred from a non-PRRT paying project (that is, project expenditures exceed project receipts) to a paying PRRT project (that is, project receipts exceed project expenditures) provided the two projects have common ownership for the entire period from when the expenditure is incurred to when the expenditure is transferred and deducted.

Second, the offshore exploration incentive in the PRRT allows an immediate 150 per cent uplift on PRRT deductions for exploration expenditure incurred in designated offshore frontier areas (for example, $100 of expenditure on exploration in a designated frontier area results in a $150 deduction for PRRT purposes). Offshore frontier areas are designated by the Minister administering the *Offshore Petroleum Act 2006* (presently the Minister for Resources and Energy) and may constitute up to 20 per cent of exploration permit areas released in a year. They must be located more than 100 kilometres from an existing commercialised oil discovery, and they must not be adjacent to an area designated in the previous year's acreage release. This measure applies to the annual offshore acreage releases for 2004 to 2009.

The PRRT is administered by the Australian Taxation Office. All the revenue raised by the PRRT is retained by the Australian Government.

Crude oil excise

The crude oil excise applies to all crude oil production within the North-West Shelf project area at various rates. It also applies to onshore crude oil projects (although there are currently no onshore projects that currently pay the crude oil excise). The first 4,767.3 megalitres (or 30 million barrels) of stabilised crude petroleum oil produced from a petroleum field is exempt from crude oil excise.

Once the producing field exceeds this threshold, the crude oil excise rates apply to each annual production tranche of crude oil. The rates applied to each annual production tranche depend on whether the petroleum field was discovered before, or on or after 18 September 1975. The top crude oil excise rate (which applies once production reaches around 3.8 million barrels in a year) is 55 per cent in the case of petroleum discoveries prior to 18 September 1975 (called 'old oil'), and 30 per cent (once production reaches around 5 million barrels in a year) in the case of petroleum discoveries on or after 18 September 1975 (called 'new oil'). The top crude oil excise rate (which applies once production reaches around 3.8 million barrels in a year) is also 55 per cent in the case of those petroleum discoveries made prior to 18 September 1975 but that remained undeveloped as at 23 October 1984 (called 'intermediate oil').

Since 13 May 2008, the crude oil excise has also applied to the production of condensate (light crude oil extracted from natural gas).

Applying the crude oil excise to condensate increases the return to the Australian community from allowing private interests to extract non-renewable energy resources located in the North-West Shelf project area and onshore.

All condensate production from petroleum fields located in the North West Shelf Project area and onshore Australia is subject to the crude oil excise. The excise rates applied to condensate are the same as the rates applied to crude oil from petroleum fields discovered after 18 September 1975. Similar to production of crude oil, the first 4,767.3 megalitres (or 30 million barrels) of condensate produced from a field is exempt from crude oil excise. Past production of condensate from a petroleum field contributes towards meeting this threshold.

The crude oil excise is administered by the Australian Taxation Office. The Australian Government retains all revenue raised from the crude oil excise.

Offshore petroleum royalty

The offshore petroleum royalty applies to production of crude oil, condensate and natural gas within the North-West Shelf project area. It is set at a rate of 10 to 12.5 per cent of net well head value. The net well head value is generally determined by deducting allowable costs from the point that a market value can be independently established for the petroleum product (usually the point of sale) back to the well head.

The offshore petroleum royalty is administered by the Australian Department of Resources, Energy and Tourism. The revenue collected is shared with the WA Government, with WA receiving approximately two-thirds of total revenue collections and the Australian Government receiving approximately one-third.

Inland waters royalty

The inland waters royalty applies to certain coastal petroleum projects in WA. The inland waters royalty is set at the same rate as the offshore petroleum royalty.

The inland waters royalty is administered by WA. Around two-thirds of the revenue is allocated to WA and one-third to the Australian Government.

Resource rent royalty

Resource rent royalty applies to production of crude oil from Barrow Island (located on the North-West Shelf). It stems from an agreement between the Australian and West Australian governments and the project operator. The Barrow Island agreement is the only agreement of its type in operation.

The resource rent royalty is administered by WA. One-quarter of the resource rent royalty from Barrow Island is allocated to WA and three-quarters is allocated to the Australian Government.

Revenue

Table 1 shows revenue collected by the Australian Government from secondary tax regimes (excise and royalties) applied to the production of petroleum in 2007-08.

TABLE 1: AUSTRALIAN GOVERNMENT REVENUE FROM SECONDARY TAX REGIMES APPLIED TO PETROLEUM PRODUCTION 2007-08

Production Taxation Type	Total Production Tax ($m)	Commonwealth share ($m)	WA share ($m)
PRRT	1,871	1,871	0
Other arrangements			
Offshore petroleum royalty	1,158	397	761
Crude oil excise	346	346	0
Internal waters royalty	34	13	20
Resource rent royalty	54	41	14
Total of other arrangements (ie. excluding PRRT)	**1,592**	**797**	**795**
Total petroleum revenues	**3,463**	**2,668**	**795**

State royalty arrangements

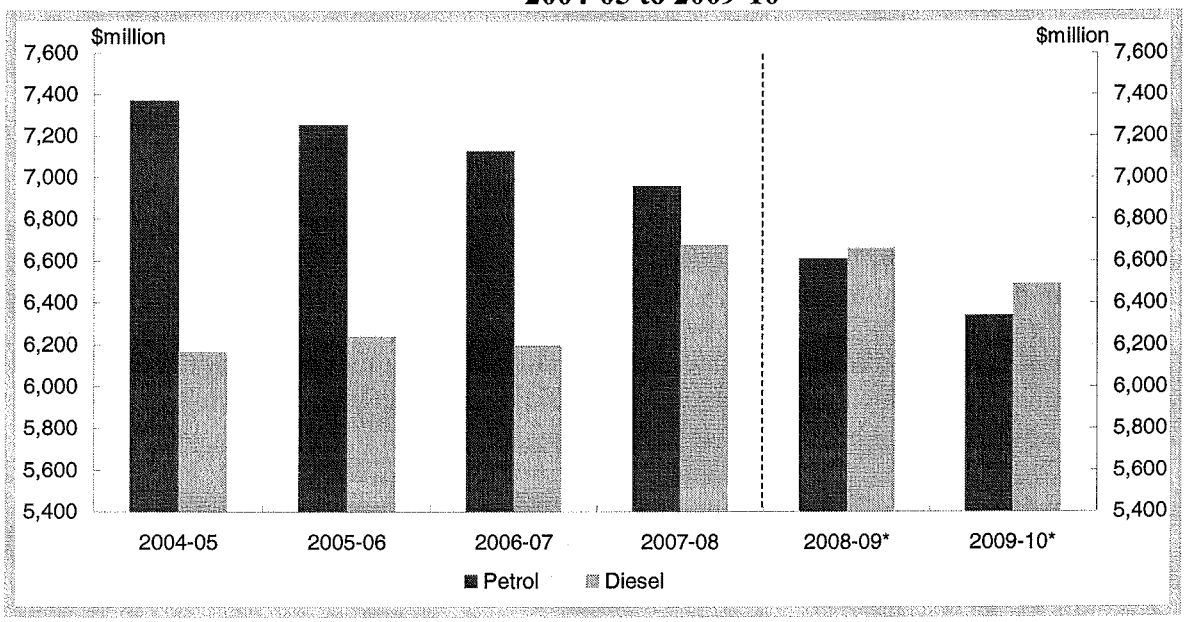
The State and Territory governments apply an ad valorem royalty to production of petroleum in their respective jurisdictions. An ad valorem royalty is typically set at 10 per cent based on the net well head value. Revenue collections from these royalty arrangements are small.

4. CURRENT FUEL TAXATION ARRANGEMENTS APPLYING TO PETROL AND DIESEL

Excise or excise-equivalent customs duty applies to petrol and diesel at a fixed rate of 38.143 cents per litre. The legal incidence of excise falls primarily on the manufacturer or importer of the fuel. The GST also applies to the excise-inclusive price of petrol and diesel at a single uniform rate of 10 per cent.

Chart 5 shows a gradual decline in petrol excise receipts since 2004-05, while diesel excise receipts increased in 2007-08 but are estimated to fall over the following three years. It is estimated that excise receipts on petrol will total $6.3 billion dollars in 2009-10 and excise receipts on diesel will total $6.5 billion over the same period.[13] The excise collections on petrol and diesel do not include petrol and diesel used in fuel blends such as E10 (which consists of 90 per cent petrol and 10 per cent ethanol).

CHART 5: COMMONWEALTH FUEL EXCISE REVENUE 2004-05 to 2009-10



*Budget estimate

Source: Revenue estimates taken from Commonwealth of Australia 2009, *Budget Paper No. 1 2009-10*, p.5-29; Commonwealth of Australia 2008, *Budget Paper No. 1 2008-09*, p.5-20; Commonwealth of Australia 2007, *Budget Paper No. 1 2007-08*, p.5-16; and Commonwealth of Australia 2006, *Budget Paper No. 1 2006-07*, p.5-16

Fuel tax credits

Broadly speaking, the excise on fuel used as a business input is offset by fuel tax credits. Fuel tax credits are still being phased in for some off-road business activities and final rates are scheduled to take effect from 1 July 2012. Further information on eligible fuels and current rates can be found on the Australian Taxation Office website at http://www.ato.gov.au/businesses/content.asp?doc=/content/00174722.htm.

[13] Commonwealth of Australia 2009, *Budget paper No. 1 Table 10: Excise and customs duty revenue*, page 5-29.

Eligibility for fuel tax credits depends upon the vehicle used and/or the activity undertaken. In general, fuel tax credits are payable in the following circumstances:[14]

- business activities previously eligible for off-road grants under the Energy Grants (Credits) Scheme. These include agriculture, fishing, forestry, mining, marine transport, rail transport, nursing and medical, and fuel used as an input or ingredient in the manufacture of products; and
- electricity generation.

Generally, other off-road business activities became eligible for a credit equal to 50 per cent of the effective fuel tax paid on the fuel on 1 July 2008. This is scheduled to increase to a full fuel tax credit from 1 July 2012.

The amount of fuel tax credits paid is equivalent to the effective fuel tax paid. Generally, effective fuel tax is the fuel tax (excise or excise-equivalent customs duty) paid less any grants or subsidies on that fuel.

Heavy on road-transport is eligible to a fuel tax credit less the non-hypothecated road user charge. The road user charge is 21.7 cents per litre as at 1 July 2009.

Road user charge

As noted earlier, fuel tax credits for on-road use are generally restricted to heavy vehicles (vehicles with a gross vehicle mass greater than 4.5 tonnes)[15] and are equal to the effective fuel tax paid less the non-hypothecated road user charge.

The road user charge is intended to compensate the Australian Government for spending on roads used by heavy vehicles and reflects the damage to roads caused by such vehicles. The road user charge forms part of the national heavy vehicle charging arrangements.

The National Transport Commission is responsible for reviewing the national heavy vehicle charges and making recommendations to the Australian Transport Council (a ministerial forum consisting of the Australian Minister for Transport and state and territory counterparts).

In 2008, the Australian Transport Council agreed to a new annual adjustment method to calculate the road user charge on fuel for heavy vehicles. In general, the annual adjustment formula calculates changes in road expenditure and expected changes in road use (via the number of heavy vehicles and kilometres travelled). The annual adjustment formula can be summarised as:

$$\text{Annual Adjustment (\%)} = \text{Road Expenditure Factor (\%)} + \text{Road Use Factor (\%)}^{16}$$

Under this formula, the road user charge increased from 21 cents per litre, to 21.7 cents per litre on 1 July 2009.

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[14] Commonwealth of Australia 2006, *Fuel Tax Bill 2006 Revised Explanatory Memorandum*, pages 10-15.

[15] Diesel vehicles acquired before 1 July 2006 can also equal 4.5 tonne GVM.

[16] National Transport Commission 2009, *2009 Heavy Road User Charge Annual Adjustment Consultation Document*, pages 1-2.

5. CURRENT FUEL TAXATION ARRANGEMENTS AND SUBSIDIES APPLYING TO BIODIESEL AND ETHANOL

Biodiesel

Excise applies to domestically produced biodiesel and excise-equivalent customs duty applies to imported biodiesel, at the rate of 38.143 cents per litre. Both of these duties for biodiesel are offset by a subsidy of 38.143 cents per litre via the Energy Grants (Cleaner Fuels) Scheme for biodiesel that meets the relevant fuel quality standards in the *Fuel Quality Standards Act 2000*. GST also applies to the excise-inclusive price of biodiesel.

Ethanol

Excise also applies to domestically produced ethanol, while excise-equivalent customs duty applies to imported ethanol at 38.143 cents per litre.

The excise payable on ethanol is offset by the Ethanol Production Grant Program. However, imported ethanol does not qualify for this scheme. Consequently, imported ethanol is currently subject to excise-equivalent customs duty, while domestically produced ethanol pays no effective excise.[17]

The Ethanol Production Grant Program is intended to encourage the use of ethanol as a transport fuel.[18] The Department of Resources, Energy and Tourism has policy responsibility for the measure and it is administered by AusIndustry under contract. Forward appropriations for the Ethanol Production Grant Program are $160 million in 2009-10 and $183 million in 2010-11.[19]

The Energy Grants (Credits) Scheme – biodiesel and ethanol

The Energy Grants (Credits) Scheme was introduced in 2003 to replace the Diesel and Alternative Fuels Grants Scheme and the Diesel Fuel Rebate Scheme.[20] The Energy Grants (Credits) Scheme has largely been replaced with the introduction of fuel tax credits, however, alternative fuels remain under the Energy Grants (Credits) Scheme. The Energy Grants (Credits) Scheme allows alternative fuels used on road in heavy vehicles to access a grant subject to certain restrictions.[21]

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[17] Under proposals of the former Government set out in the 2004 Energy White Paper, *Securing Australia's Energy Future*, the Energy Grants (Cleaner Fuels) Scheme was to apply to domestic and imported ethanol. In addition, the value of the grants under the Energy Grants (Cleaner Fuels) Scheme was to be phased down in five equal steps from 1 July 2011 and conclude at the end of 30 June 2015.

[18] AusIndustry, *Ethanol Production Grants (EPG)* at http://www.ausindustry.gov.au/EnergyandFuels/EthanolProductionGrantsEPG/Pages/EthanolProductionGrants(EPG).aspx.

[19] Department of Resources, Energy and Tourism 2009, *Portfolio Budget Statements 2009-10* http://www.ret.gov.au/Department/Documents/Portfolio%20Budget%20Statements.pdf, page 33.

[20] Commonwealth of Australia 2003, *Bills Digest No. 119 2002–03 Energy Grants (Credits) Scheme Bill 2003*, at http://www.aph.gov.au/library/pubs/bd/2002-03/03bd119.pdf.

[21] Heavy vehicles of 20 tonnes or more used for transporting passengers and goods have no restrictions. Heavy vehicles of 20 tonnes or more used other than for transporting passengers and goods can claim for fuels used in travelling to and from operating sites. Heavy vehicles of 4.5 to less than 20 tonnes used to transport passengers and goods are only eligible for fuel used in non-metropolitan areas.

The current value of the grant is 3.702 cents per litre for biodiesel and 4.162 cents per litre for ethanol. The value of the Energy Grants (Credits) Scheme does not impact on a registered business's entitlement to a fuel tax credit under the *Fuel Tax Act 2006*. As a result, biodiesel and ethanol eligible for the Energy Grants (Credits) Scheme receive a subsidy in addition to paying an effective tax rate of zero.[22]

The Energy Grants (Credits) Scheme is administered by the Australian Taxation Office under the *Energy Grants (Credits) Scheme Act 2003*.

The Energy Grants (Credits) Scheme is being phased out over the four years from 1 July 2006 to 30 June 2010.

Fuel blends and fuel tax credits – biodiesel and ethanol

Where a fuel blend meets a particular fuel standard (outlined in the *Fuel Quality Standards Act 2000*), for instance the petrol or diesel standard, it is treated as having fuel tax paid on it at the rate applicable to the unblended fuel covered by the standard. For fuel blends where one of the constituents attracts fuel tax at a discounted rate, such as a blend of diesel and biodiesel, the result of this treatment is a fuel tax credit in excess of the fuel tax actually embedded in the price of the fuel. Where a fuel blend does not meet a fuel standard, the amount of fuel tax credit will not be more than the actual fuel tax embedded in the price of the fuels that make up the blend.[23]

[22] There are also other forms of eligible fuels such as LPG, LNG and CNG which are discussed below.

[23] Commonwealth of Australia 2006, *Fuel Tax Bill 2006 Revised Explanatory Memorandum*, page 16

6. CURRENT FUEL TAXATION ARRANGEMENTS AND SUBSIDIES APPLYING TO LPG, LNG AND CNG

LPG, LNG and CNG are not currently subject to excise or excise equivalent-customs duty. However, GST applies to these fuels.

LPG, LNG and CNG are able to access grants under the Energy Grants (Credits) Scheme when used in heavy vehicles. The current value of the grants is 2.385 cents per litre for LPG, 1.626 cents per litre for LNG and 2.523 cents per litre for CNG.

7. IMPACT OF THE CARBON POLLUTION REDUCTION SCHEME ON FUEL

In the *Carbon Pollution Reduction Scheme: Australia's Low Pollution Future*, the Government outlined transitional arrangements for fuel taxation to give households and businesses time to adjust to the Carbon Pollution Reduction Scheme (CPRS). These include an automatic 'cent-for-cent' reduction in excise and the equivalent customs duty rate, and the introduction of a CPRS fuel credit. These measures are set out in the Carbon Pollution Reduction Scheme (CPRS Fuel Credits) Bill 2009, Carbon Pollution Reduction Scheme (CPRS Fuel Credits) (Consequential Amendments) Bill 2009, Excise Tariff Amendment (Carbon Pollution Reduction Scheme) Bill 2009 and the Customs Tariff Amendment (Carbon Pollution Reduction Scheme) Bill 2009. These Bills are currently before Parliament.

Fuel tax reduction

The Government has committed to providing transitional assistance to households in the form of a 'cent-for-cent' reduction in fuel taxes, to offset the increase in the cost of fuel arising from the need for fuel producers to acquit CPRS emission units for the carbon released when the fuel is burnt.

The adjustment is based on the increase in the average Australian emissions unit charge for the preceding six months, with a one-month lag. There will be no adjustments for a decrease in the emissions unit charge. There will be an initial reduction on 1 July 2011 of 2.455 cents per litre (based on current taxation arrangements) to offset the increase in costs attributable to the initial $10 per tonne CPRS unit charge. The fuel excise will be reviewed automatically every six months from 1 July 2012 until 1 July 2014. The diesel emission rate of 2.7 kilograms per litre will be used to calculate the application of the CPRS unit charge to fossil fuels. The Commissioner of Taxation will gazette the excise rate if an amendment is necessary.

The excise rate will not revert back to 38.143 cents per litre at the completion of the transition period but will remain at its 1 July 2014 rate. There will be a review of the transitional assistance at the end of the transition period.

Introduction of CPRS fuel credits

The Government will also provide transitional assistance to agriculture, fishing and heavy on-road transport users, and LPG, LNG and CNG suppliers, in the form of a CPRS fuel credit. The agriculture, fishing and heavy road transport (gross vehicle mass exceeding 4.5 tonnes) industries effectively do not pay fuel excise due to receiving fuel tax credits and thus will not benefit from the excise reduction. Partial CPRS fuel credits (at a rate of 50 per cent) will be available to industries engaged in activities incidental to the agriculture and fishing industries.

The gaseous fuels will incur a CPRS unit charge but are outside the excise system, and therefore households and business users will not benefit from the fuel tax cuts. As the CPRS unit charge will be lower for the gaseous fuels than for the fossil fuels, the CPRS fuel credit for the gaseous fuels will be proportionally lower than for the fossil fuels:

- CNG 78 per cent (1.915 cents per cubic metre);
- LPG 67 per cent (1.645 cents per litre); and
- LNG 50 per cent (1.227 cents per litre).

The CPRS fuel credit will be claimed on the Business Activity Statement.

The CPRS fuel credits will be available from 1 July 2011 and thereafter will be adjusted automatically to reflect CPRS-related reductions in the fuel tax excise.

The CPRS fuel credit entitlements for the agriculture and fishing industries and eligible LPG suppliers will cease on 30 June 2014. The CPRS fuel credit entitlements to the heavy on-road transport (gross vehicle mass exceeding 4.5 tonnes) users and eligible LNG and CNG suppliers will cease on 30 June 2012.

8. THE AUSTRALIA'S FUTURE TAX SYSTEM REVIEW

On 13 May 2008, the Treasurer announced a comprehensive review of Australia's Future Tax System (AFTS). The Review Panel, chaired by the Secretary to the Treasury, is considering, among other things, excise taxes as well as tax and royalty arrangements for natural resource charging.

This includes consideration of taxes on petrol, diesel and alternative fuels. While the review is precluded from increasing the rate or broadening the base of the GST, the Panel has been specifically asked to consider the interaction between fuel excise and the GST.

The Panel's Consultation paper, released on 10 December 2008, outlines many of the issues raised in the course of public submissions and consultation with stakeholders. Chapter 12 of the Consultation paper deals specifically with taxation issues surrounding transport fuels. Chapter 14 considers the principal issues the Panel has identified surrounding natural resource charging.

A copy of the consultation document can be accessed at the review's website: http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/pubs_reports.htm.

The Review Panel will provide a final report to the Treasurer by the end of 2009 for the Government's consideration.

Alternative fuels are also being examined in the context of the Energy White Paper *Enhancing Australia's Economic Prosperity* announced by the Minister for Resources and Energy.

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