

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HMRC</b>	<b>Title:</b> <b>Impact Assessment of the implementation of the Energy Products Directive (EPD) on private and pleasure boats.</b>	
<b>Stage:</b> Consultation	<b>Version:</b> 1	<b>Date:</b> 1 August 2007
<b>Related Publications:</b> Impact Assessment of the implementation of Energy Products Directive on private pleasure flying		

**Available to view or download at:**

<http://www.hmrc.gov.uk>

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**What is the problem under consideration? Why is government intervention necessary?**

Private pleasure boats were permitted, under an EU derogation, to use marked rebated fuel (red diesel) for propulsion purposes. This derogation expired in December '06 despite the UK submitting an application for renewal. The use of red diesel for domestic purposes (to generate heat and light), however, is still permitted, as is its use by commercial vessels for propulsion.

The Government needs to implement a scheme that ensures that we comply with the terms of the EPD, while taking all of these factors into account.

**What are the policy objectives and the intended effects?**

To implement a scheme to comply with the EPD which:

- a) minimises the tax and administrative burdens on the industry,
- b) recognises that rebated fuel can still legitimately be used for domestic purposes
- c) is proportionate to the revenue at risk

**What policy options have been considered? Please justify any preferred option.**

Doing nothing is not an option as this puts us in breach of the EPD and opens us to the possibility of infraction proceedings. Other options identified so far are:

- a) private pleasure vessels to continue to use marked fuel, but at the duty rate for heavy oil, repaying the rebated duty via the RDCOs who will declare this to HMRC. This is the preferred option
- b) private pleasure vessels to continue to use marked fuel, but at the duty rate for heavy oil repaying the rebated duty via a self regulated scheme
- c) require all private and pleasure vessels to use unmarked ULSD

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** November 2010

**Ministerial Sign-off** For consultation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:

.....Date:

## Summary: Analysis & Evidence

<b>Policy Option: a)</b>	<b>Description: The continued use of red diesel at the heavy oil rate, with private and pleasure boat owners repaying the rebate via the RDCOs who will declare this to HMRC.</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups'
	<b>One-off</b> (Transition) <b>Yrs</b>	
	£	
	<b>Average Annual Cost</b> (excluding one-off)	
	£	<b>Total Cost (PV)</b> £
<p><b>Other key non-monetised costs</b> by 'main affected groups'</p> <p>Impact on competition between suppliers. Cost of increased enforcement responsibility for HMRC has not been estimated. Cost of increased burden on RDCOs has not been estimated.</p>		

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups'
	<b>One-off</b> <b>Yrs</b>	
	£	
	<b>Average Annual Benefit</b> (excluding one-off)	
	£ 0.5m – 1.5m	<b>Total Benefit (PV)</b> £ Ongoing
<p><b>Other key non-monetised benefits</b> by 'main affected groups'</p>		

**Key Assumptions/Sensitivities/Risks** Estimates of compliance costs highly dependent upon number of boats, the number of claims for rebates and the time taken to keep records and submit claims for individual boat owners. Environmental benefit dependent upon size of behavioural impact.

Price Base Year 2007	Time Period Years ongoing	<b>Net Benefit Range (NPV)</b> £ N/A	<b>NET BENEFIT (NPV Best estimate)</b> £ N/A
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What is the geographic coverage of the policy/option?		UK	
On what date will the policy be implemented?		1 November 2008	
Which organisation(s) will enforce the policy?		HMRC	
What is the total annual cost of enforcement for these organisations?		£	
Does enforcement comply with Hampton principles?		Yes	
Will implementation go beyond minimum EU requirements?		No	
What is the value of the proposed offsetting measure per year?		£ N/A	
What is the value of changes in greenhouse gas emissions?		£ 1m	
Will the proposal have a significant impact on competition?		No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium      Large
Are any of these organisations exempt?	No	No	N/A      N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)	
Increase of    £ Neg	Decrease of    £ Nil	<b>Net Impact</b>	£ Neg

Key:      Annual costs and benefits: Constant Prices      (Net) Present Value

## Summary: Analysis & Evidence

Policy Option: b)

Description: The continued use of red diesel at the heavy oil rate, with private and pleasure boat owners repaying the rebate via a self regulated scheme

<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' Option imposes new obligations on pleasure boat owners (around £8m) and will require additional processing by HMRC (around £7m). These costs are ongoing
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	£		
	<b>Average Annual Cost</b> (excluding one-off)		
	£ 15m (10m to 20m)		<b>Total Cost (PV)</b> <b>£ Ongoing</b>
<b>Other key non-monetised costs</b> by 'main affected groups' There will be large one-off and ongoing costs for HMRC to establish a registration system for boats which has not been costed. Impact on competition between suppliers has not been estimated.			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' Reduction in carbon and other emissions from fall in fuel use.
	<b>One-off</b>	<b>Yrs</b>	
	£		
	<b>Average Annual Benefit</b> (excluding one-off)		
	£ 0.5m to 1.5m		<b>Total Benefit (PV)</b> <b>£ Ongoing</b>
<b>Other key non-monetised benefits</b> by 'main affected groups'			

**Key Assumptions/Sensitivities/Risks** Estimates of compliance costs highly dependent upon number of boats, the number of tax returns and the time taken to keep records and submit claims for individual boat owners. Environmental benefit dependent upon size of behavioural impact.

Price Base Year	Time Period Years	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £
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What is the geographic coverage of the policy/option?			UK		
On what date will the policy be implemented?			1 November 2008		
Which organisation(s) will enforce the policy?			HMRC		
What is the total annual cost of enforcement for these organisations?			£		
Does enforcement comply with Hampton principles?			Yes		
Will implementation go beyond minimum EU requirements?			No		
What is the value of the proposed offsetting measure per year?			£ N/A		
What is the value of changes in greenhouse gas emissions?			£ 1m		
Will the proposal have a significant impact on competition?			No		
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		N/A	N/A	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)	
Increase of	£ Nil	Decrease of	£ Nil	<b>Net Impact</b> £ Nil

Key:    Annual costs and benefits: Constant Prices    (Net) Present Value

## Summary: Analysis & Evidence

<b>Policy Option: c)</b>	<b>Description: Require all private and pleasure craft to use ULSD</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups' High one-off cost mainly to install new tanks for ULSD on boats will fall on boat owners	
	<b>One-off</b> (Transition) <span style="float: right;"><b>Yrs</b></span>		
	<b>£ 250m</b>		1
	<b>Average Annual Cost</b> (excluding one-off)		
<b>£ 0.25m</b>	<b>Total Cost (PV)</b> <b>£ ongoing</b>		
Other <b>key non-monetised costs</b> by 'main affected groups' Increased ongoing costs of security for boat owners. Increased costs of enforcement by HMRC.			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' Reduction in carbon and other emissions from fall in fuel use.	
	<b>One-off</b> <span style="float: right;"><b>Yrs</b></span>		
	<b>£</b>		
	<b>Average Annual Benefit</b> (excluding one-off)		
<b>£ 0.5m to 1.5m</b>	<b>Total Benefit (PV)</b> <b>£ ongoing</b>		
Other <b>key non-monetised benefits</b> by 'main affected groups'			

<b>Key Assumptions/Sensitivities/Risks</b> High total cost of installing new tanks is highly dependent upon estimate of average installation cost.
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Price Base Year 2007	Time Period Years ongoing	<b>Net Benefit Range (NPV)</b> <b>£ N/A</b>	<b>NET BENEFIT (NPV Best estimate)</b> <b>£ N/A</b>
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	1 November 2008
Which organisation(s) will enforce the policy?	HMRC
What is the total annual cost of enforcement for these organisations?	£
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	No
What is the value of the proposed offsetting measure per year?	£ N/A
What is the value of changes in greenhouse gas emissions?	£ 1m
Will the proposal have a significant impact on competition?	No
Annual cost (£-£) per organisation (excluding one-off)	Micro      Small      Medium      Large
Are any of these organisations exempt?	No      No      N/A      N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)
Increase of    £ Neg	Decrease of    £ Nil	<b>Net Impact</b> £ Neg

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

### Problem under consideration

1. UK legislation on oils taxation is contained in the Hydrocarbon Oil Duties Act 1979 (HODA). The EU legislation governing mineral oils structure and rates was contained in three directives (92/80/EEC, 92/81/EEC and 92/82/EEC) which sought to harmonise the treatment of mineral oils for taxation purposes. Some aspects of HODA were incompatible with the directives; however, derogations were negotiated to cover these inconsistencies. These expired on 31 December 2006.
2. The mineral oils directives were repealed by the introduction of the EPD in 2004. This removed the need for some of the derogations; however; the remaining ones retained their expiry date of 31 December 2006. One of these derogations related to the treatment of fuel used in private pleasure boats. Under the terms of the mineral oils directives and then subsequently the EPD, fuel for private pleasure boats was to attract the full rate of duty. The derogation permitted the UK to charge duty for this fuel at the rebated rate.
3. We applied for renewal of the derogation; however, our application was rejected on the grounds that, since the fuel had been taxable in principle since 1993, member states had had enough time to adapt to the requirements of community law. The Commission also did not accept our case that there would be additional administrative burdens or compliance costs resulting from the expiry of the derogations. They stated that if such arguments were to be accepted then the derogation would need to be maintained indefinitely, contradicting the principles that derogations are time limited and introduced with the aim of assisting with initial difficulties encountered with the introduction of new regimes.
4. Applications for renewal of similar derogations submitted by other member states have also been rejected.
5. Ministers have decided to implement the changes with effect from November 2008 (announced in Budget 2007), which would require legislation in Finance Bill 2008.
6. We have written to the Commission to this effect. With this in mind, our timetable is as follows:
  - Consulting in summer '07
  - Announcing in Nov/ Dec
  - Legislating in Budget '08
  - Implementation November 2008
7. On the wider issue of timetables, we believe that other member states appear to have either already taken action or have plans to take action by spring 2008 at the latest. In short, we appear to be approximately 6 months behind most other member states.
8. We have already met informally a number of stakeholders who have all expressed concern at the expiry of the pleasure boat derogations, seeking information on our latest thinking and to present their preferred options.
  - The Royal Yachting Association (RYA)
  - The British Marine Federation (BMF)
  - The Inland Waterways Association (IWA)
  - The Federation of Petroleum Suppliers (FPS)

■ The Residential Boat Owners' Association (RBOA)

9. At this stage a number of options have been discussed. Each brings compliance, enforcement, resource and administrative burdens for both the industry and HMRC. Consequently, none other than the 'do nothing' option has been ruled out.
10. To do nothing would result in infraction proceedings being instigated, and, although the Commission had indicated that they were prepared to allow us some flexibility in arriving at a suitable regime, they were also clear that, having had the derogation in place now for a number of years, we have had sufficient time to arrive at a solution. Their response to our note advising them of our planned timetable was that they were disappointed at the time frame in which we intended to work.
11. Ministers have said that we would look for ways of implementing the new regime which would both minimise the impact, and ensure that any additional compliance burden was as small as possible. We, therefore, need to bear in mind that any proposed system must be proportionate to the revenue at risk and should recognise that:
  - private pleasure craft will continue to be able to use red diesel legitimately for purposes other than propulsion;
  - private pleasure craft will be free to use red diesel bought from the Channel Islands;
  - red diesel bought at the current rate will remain in tanks for long periods, and traces will remain even longer; and
  - there is a need to minimise any restriction on boat owners' ability to travel because of non-availability of fuel.

**Current position -**

12. Private pleasure craft are currently able to use gas oil (diesel) on which duty has been partially rebated. The current effective rate of duty on rebated gas oil is 7.69 pence per litre (ppl). Use of rebated gas oil is not permitted in road vehicles, and for this reason the fuel contains a combination of markers and dyes to enable misuse to be detected. For this reason it is commonly known as "red diesel".
13. The BMF estimate there are approximately 500,000 private pleasure boats in the UK, of which 350,000 are motor boats and therefore depend on engines for propulsion. This includes both diesel and petrol craft. A proportion of these will be residential in nature, and will also use their engines to provide energy for heat, light and other domestic purposes, and a proportion will also be available for charter or hire and thus fall into the criteria for commercial craft for part of the time.
14. There are no accurate data on the number or types of boats in the UK, either commercially or privately owned. A licensing system exists for boats on the inland waterways; however, these are operated by three authorities who between them cover the UK inland waterways. The authorities and the areas they cover are:
  - British Waterways Authority (BWA) – covers almost all the canals and rivers such as the Severn, Trent and Yorkshire Ouse
  - Environment Agency - covers the Thames, the Medway and rivers of East Anglia with each region having its own registration and licensing system.
  - Broads authority - covers the Norfolk and Suffolk broads.
15. All the authorities require boats using the inland waterways to register and to display their registration number. The BWA enforce registration for their scheme and have compliance teams who patrol the waterways for unregistered craft. This scheme, however, is for inland waterways only and a comparable scheme for coastal craft does not appear to exist. The scheme also does not classify boats by type (cruisers, residential, etc).

### *Supply infrastructure*

16. Typically, suppliers of fuel to the boat industry provide only one type of diesel fuel – rebated red diesel. This is used both by commercial and private pleasure craft and in addition, depending on their location; some suppliers may also supply fuel for use in agriculture and plant machinery. It should be noted that the removal of the derogation has no effect on commercial use: commercial craft will continue to be free to use red diesel, and in the case of commercial marine craft will continue to be eligible for full duty relief under Marine Voyages Relief.
17. Fuel sites are typically located in harbours, at marinas, on floating barges and on towpaths and in many areas are few and far between. Supplying a second stream of fuel would involve substantial additional costs for suppliers, and would require new storage space for which planning permission is likely to become increasingly difficult. Boat owners fear that many of the suppliers with a wide customer base (commercial and agriculture) will simply opt to continue to provide only rebated fuel. There is anecdotal evidence that suppliers are already taking this decision. Smaller suppliers who cater for private pleasure craft only, faced with the not insignificant additional cashflow and security costs of supplying unrebated fuel, may just close. In either case the end effect would be to reduce the already limited number of fuel stations that service private pleasure craft. The likelihood of being able to refuel in fewer locations (particularly in remote areas) is a very real concern for boat owners, who fear that certain parts of the country (such as the Scottish highlands and islands) will, in effect, become out of bounds for pleasure craft simply because it will be impossible to refuel other than with red diesel.
18. The cost of installing new pumps and tanks have been estimated to be in the region of £20,000 (£12,000 for a tank, £6,000 for pumps and £2,000 for installation)

### *Fuel for domestic power*

19. Private pleasure boats are currently able to use rebated fuel legitimately both for propulsion and to provide heat and light. As a result of the changes required by the expiry of the derogation the use of rebated fuel will only be permitted for heating and lighting. Fuel for propulsion will need to be charged at the full rate. However, because space is at a premium on boats, they normally contain only one tank from which fuel is drawn for both propulsion and domestic purposes. In order to continue to use red diesel at the rebated rate for domestic purposes it will be necessary for boat owners to quantify and separate this from the fuel used for propulsion and this may require the installation of a second tank. The cost of fitting a second tank, where space is available would vary depending on the size and type of boat; however estimates of about £750 have been quoted for a typical inland cruiser.
20. The RBOA estimate that, for boats used as residences, over 60% of fuel taken on board is used for domestic purposes (i.e. heating and lighting). Based on an average annual fuel consumption figure of 1200 litres, 720 would be for domestic purposes. There are, however, no reliable figures for the number of residential boats in the UK and it is therefore not possible to estimate what percentage of the total boat market will be affected by this.
21. Under any option consideration would need to be given to whether special arrangements should appertain in the case of residential craft (houseboats and continual cruisers).

### **Main stakeholders**

22. The main groups affected by this measure have been identified as:
  - Owners of private pleasure craft.
  - Suppliers of fuel to the boat owners

■ HMRC

23. Commercial craft are unaffected by the expiry of the derogation and can continue to use rebated fuel.

### Options for change

*To continue to use red diesel but pay the full rate of duty.*

24. We have met a number of stakeholders informally who have expressed a preference for continuing to have the option of using red diesel while paying the full rate of duty. Since most rebated fuel used in private pleasure boats is high in sulphur the full rate of duty charged will be 54.68ppl. This is the current rate of duty for heavy oil that is not ultra low sulphur diesel (ULSD), and represents an increase of over 600% from the current rebated fuel rate of 7.69 ppl. (ULSD has a lower duty rate of 48.35ppl in recognition of the fact that it is a less polluting fuel).
25. There are two ways to take this option forward. Either
- the supplier could collect duty on sales to private pleasure craft or
  - under a self regulated scheme boat owners could purchase fuel at the rebated rate and then pay the balance of duty (on a frequency to be determined).

(See options A and B below for more detail on both these options.)

26. The benefit of continuing to use marked fuel is that the supply infrastructure is already in place, and existing equipment and tankage can continue to be used. Fuel would continue to be available to pleasure craft throughout the UK, and there would be no restraint on pleasure cruising as a result of pleasure craft being unable to refuel. It would, however, have resource and cost implications for HMRC who would need to devise a compliance and enforcement regime, and compliance burdens for fuel suppliers and/ or boat owners, depending on how the scheme was administered.
27. Specifically legislation would need to be introduced to tighten laws around the use of marked fuel to make it an offence to use this as road fuel irrespective of the rate of duty paid.
28. This scheme also has EU implications as in some member states the use of marked fuel in pleasure craft is not permitted. This, however, has always been the situation.

#### *Option A – Supplier collects duty.*

29. Rebated fuel is supplied only by Registered Dealers in Controlled Oils (RDCOs) who are required to maintain records of their sales. Under this option RDCOs who chose to supply fuel to private pleasure craft would be required to identify such sales, charge the higher rate of duty at the point of sale and pay this to HMRC when they submitted their return.
30. If special arrangements were to be introduced for domestic use by houseboats this could be done by the introduction of a certification scheme under which houseboat owners would need to produce the certificates before being able to purchase the fuel at the reduced rate
31. This option would impose a number of burdens on fuel suppliers, boat owners and HMRC, and create a number of potential fraud opportunities which would need to be addressed.
- HMRC would need to devise and operate a compliance and enforcement regime.
  - It would place the onus on fuel suppliers to determine who was ineligible for fuel supplied at the rebated rate (and thus who should pay the full rate of duty) and to maintain records, submit returns and make payments.

- It could lead to enforcement difficulties, given that there would be no obvious way of telling whether or not marked fuel in the tanks of private pleasure craft had had the full rate of duty paid on it.

32. The existing RDCO scheme does not require RDCOs to make payments of duty. RDCOs are required to simply record and declare whom they have made sales of rebated fuel to. The level of detail RDCOs are required to declare on their returns varies depending on the volume and nature of the sale. For example for domestic sales under 3500 litres and retail or pump sales only the total volume sold and the total number of sales is required. For higher volume sales individual transaction details are required. This reflects the fact that the RDCO scheme was introduced to track the sale of large quantities of rebated fuel.
33. Requiring RDCOs who chose to supply fuel to private pleasure craft to collect and account for duty on retail or pump sales will increase the administration burden on them. It would also place a compliance obligation on them as they will need to charge marked fuel at the higher rate unless they can satisfy themselves that the fuel would be put to an authorised use. In order for them to satisfy HMRC that the correct rate has been charged they will need to keep records of their individual retail sales. The likely costs of this burden are unknown and we will need to consult with the RDCOs to determine what this is.
34. Boat owners would see a significant increase in their fuel costs. The duty rate on rebated fuel is currently 7.69 ppl, compared with a duty rate of 54.68ppl for conventional diesel (ie fuel that is not ULDS or sulphur free diesel (SFD)). The table below illustrates what this would mean for an average boat owner using 1200 litres of fuel a year, not making an allowance of domestic use.

Volume per annum <sup>1</sup> (litres)	Duty applied at rebated rate	Duty applied at heavy oil rate	Difference
1200	£92.28	£656.16	£563.88

1. Figures taken from the RBOA survey.

35. However this option does allow them to continue to use red diesel and requires no change to the existing fuel supply infrastructure. By tying this into the RDCO scheme it would create an auditable supply chain.
36. Despite the additional burden this is currently our preferred option.

### Compliance Costs

37. This option will add several obligations to suppliers of red diesel and to the owners of private pleasure craft listed below.

#### RDCOs

- An obligation to identify that tax payers are paying the correct amount.
- An obligation to keep records of taxpayers paying the higher rate of duty on rebated oil.

38. Estimates for these costs, will be informed by the consultation.

#### Option B – Self regulated scheme

39. Under this option, boat owners would continue to purchase fuel at the rebated rate, but would declare the additional duty due periodically.

- 40.

41. The benefit of this option is that it would, in effect, maintain the status quo for suppliers, since the onus would be on boat owners to declare and account for duty.
42. The burden on suppliers would be less than under option A; other burdens and risks would be similar, however; there would be a significant compliance risk associated with option as there is currently no accurate record of the number of boat owners; although the inland waterways operate licensing systems, these are run regionally and cover inland boating only. Consequently there is no single system or record and no effective way of tracking or checking that duty was being declared correctly.
43. An alternative would be to create a registration system for all boats. The costs associated with this are likely to be significant and the resulting regime would still be highly resource intensive to operate and assure for both HMRC and the boat owners.
44. Given the high set up costs and significant admin burdens on both sides we do not currently consider this to be a viable option.

### Compliance Costs

45. This option will add several obligations to the owners of private pleasure craft and extra compliance costs for HMRC. There will be no additional costs for business. The cost of these obligations is described below.

#### *Pleasure boat operators*

- An obligation to keep records .
- An obligation to calculate .
- An obligation to submit a return .

46. Our current estimate of the cost of these obligations is shown in the following table:

	Upper
Population of pleasure boat owners	350,000
Time Taken	
Obligation 1	1 hrs
Obligation 2	0.75 hr
Obligation 3	0.25 hrs
No. of times per year	
Obligation 1	1
Obligation 2	1
Obligation 3	1
Total Time	2 hrs
Time cost	£12.00
Total Compliance Cost	£8m

HMRC

47. Processing returns for duty payments from pleasure boat owners. Our current estimate of the cost of this obligation is shown below:

	Central
Number of taxpayers	350,000
Average number of returns per year	1
Total Number of returns	350,000
Cost per obligation	£20
Total Cost	£7m

48. There is a likelihood of non-compliance as boat owners will have little incentive to pay tax. This is reflected in the additional obligation below for HMRC to ensure taxpayers have submitted a return.

- Identifying taxpayers not submitting tax returns.

49. There are several options for HMRC to meet this obligation, ranging from do-nothing to a full registration system for all boats. No estimates have yet been made of the cost of these options.

*Option C: Switch to fully duty-paid ULSD*

50. This option is the simplest from an administrative point of view, but is least favoured by boat owners, owing to the practical and financial issues it raises.

51. As noted in paragraph 17 above, this option would require the widespread establishment of a second fuel stream if it were not to restrict boat owners' freedom to cruise where they chose in the UK. The indications are this is unlikely to be achieved.

52. Under any scheme fuel suppliers would of course have the option of supplying only fully-duty paid ULSD, with commercial marine users reclaiming all the duty under the Marine Voyages Relief scheme (if considered appropriate a parallel relief could be set up for inland commercial users). However this would result in cashflow issues for both suppliers and users, so take up of this option is likely to be low, particularly in remote areas where commercial use predominates. If a requirement for private pleasure craft to use unmarked ULSD resulted in this option being more widely taken up it could open up opportunities for both diversion of unmarked marine fuel on which duty has been refunded and straightforward repayment fraud.

53. If boat owners were required to purge their tanks of red diesel in preparation for taking in unmarked ULSD it is estimated that this would cost between £500 and £1000. Even then, this would be unlikely to remove all traces of the rebated marker, which could be expected to contaminate fresh fuel for some time. If tanks are not cleaned red diesel would continue to be present in a tank for significantly longer (up to 5 years has been quoted by some stakeholders).

54. There are also the environmental implications of tank cleaning and the risk of fuel entering and polluting the waterways.

55. There will therefore be instances where, although red diesel will no longer be permitted to be sold in the UK as fuel for private pleasure boats, there will continue to be legitimate reasons for its presence in the main running tanks of boats.

56. To complicate matters further, the Channel Islands are not affected by the Commission's decision and so will continue to supply rebated fuel for private pleasure craft, and UK boat owners will be able to fill up with rebated fuel supplied there.
57. There is also some debate amongst the boat owners over the suitability of ULSD as a fuel. Some have argued that, since ULSD has less lubricity than rebated fuel, it may cause their engines to seize or break down. Other possible effects of using ULSD include seals shrinking, thus resulting in leakage and loss of engine pressure. Opinion remains divided on this issue, but there is anecdotal evidence that manufacturers are reluctant to offer any assurances as to the suitability of ULSD as a fuel. It is worth noting however that in remote locations (including the Channel Islands), red diesel needs are met by marking ULSD, so some boat owners are unknowingly already using ULSD.
58. In the longer term, under the terms of the Fuel Quality Directive, the sulphur content in rebated fuel will need to reduce from its current level of 2000mg/kg to 1000mg/kg by 31 December 2007 and it is likely that these levels will be reduced further with the aim of ultimately achieving a 'sulphur free' level in future.
59. The current duty rate for ULSD is 48.35 ppl and represents an increase of 40.66 ppl, or using an annual fuel consumption figure of 1200 litres, taken from the table at para 34 above, an annual increase of £487.80.
60. There would be some environmental advantage to switching to ULSD in that this is a cleaner fuel and there would be small reductions in sulphur dioxide and carbon emissions; however, the boat industry forms but a small part of the total usage of the total oils market and any savings made are likely to be negligible when considered overall.
61. In light of the above this is not currently a favoured option.

### Compliance Costs

62. This option will generate a large one-off compliance burden for both businesses who want to continue to supply and boat owners. There will be some ongoing obligations for businesses, but not for boat owners. HMRC will face an additional enforcement obligation. The following describes the different obligations for each of the three groups.

#### RDCOs

63. RDCOs intending to supply fuel to private pleasure craft will need to install a ULSD pump. The cost of this obligation will be one-off and is calculated below. It is likely that many RDCOs will choose to forgo the private pleasure craft market and not install a pump, which may suggest lower costs for business. Note the competition impact of this discussed below.

	Central Estimate
Number of RDCOs	100
Cost of installing ULSD tank	£20,000
Total Cost	£2m

64. RDCOs will face an ongoing additional cost of securing their fuel supply which is estimated below.

	Central Estimate
Number of RDCOs	100
Proportion choosing to supply ULSD	100%
Cost of securing ULSD tank	£2,500

Total Cost	£0.25m
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65. RDCOs will also face the following ongoing obligation.

- An obligation to identify that tax payers are paying the correct amount.

66. It is expected that the cost of this obligation will be negligible for individual RDCOs as with option B.

#### *Boat owners*

67. Boat owners will face an initial one-off cost of cleaning out their tanks in preparation for making the switch to unmarked ULSD..

	Central Estimate
Number of boats	350,000
Proportion choosing to carry two tanks	100%
Cost of cleaning existing tank	£750
Total Cost	£265m

68. Boat owners will face additional security costs for holding ULSD, but these have not been estimated. They will have no additional compliance costs with this option.

69. Costs for installing new tanks and equipments have been estimated and we would welcome your feedback on these.

#### *Competition impact*

70. The high cost for RDCOs of installing a new tank will be prohibitive for many. This option will therefore have the indirect impact of reducing the number of suppliers beyond just that of a price increase as with options A and B, and therefore requires a further competition assessment if taken further.

#### **Impact/ revenue at stake**

71. We estimate that the revenue gain from the expiry of the boat derogation is in the area of £10 to £15m a year. It follows that this is the maximum additional revenue at risk from private boating if, for example, boat owners were allowed to continue using red diesel but misused the scheme by (depending on the option adopted) misleading RDCO suppliers as the nature of their boat (ie commercial/ domestic), failing to submit returns or submitting false repayment claims. HMRC's enforcement effort must be proportionate to this risk. Taken in the context of a total yield of £24bn (05/06) from oils, the private pleasure craft industry would account for 0.06% of the total revenue.

#### **Compliance costs and Admin Burden**

72. All three options impose additional costs on both businesses and pleasure craft users. Those costs that are faced by businesses may impact upon the admin burden baseline. HMRC will also face additional costs in ensuring compliance with each option. We welcome feedback as part of the consultation process on the estimates of these costs.

## Carbon and Environmental Impact

73. The loss of derogations raises the price of fuel for pleasure boat propulsion and will therefore reduce the amount of fuel used for this purpose, which has a direct carbon and environmental benefit. It is estimated that private pleasure craft have the following environmental impact

	Carbon	Nitrous Oxides	Sulphur Dioxide
Fuel used	25million litres		
Fuel used	21,000 tonnes		
Amount of pollutant per tonne	0.87 tonnes	0.057 tonnes	0.0194
Amount of pollutant	18,000 tonnes	1,200 tonnes	400 tonnes
Cost per tonne of pollutant	£87	£1,600	£2,700
Total Cost	£1.6m	£1.9m	£1.1m

Source: Data on emissions per tonne from AEA Energy and Environment

74. The carbon and environmental benefit from the loss of derogations depends upon the extent of the reduction in fuel use following the increase in prices. It is expected that prices for fuel will more than double and the following table estimates a range for the potential environmental benefit.

	Lower Estimate	Central Estimate	Upper Estimate
Reduction in fuel use	25%	50%	75%
Carbon impact	£0.4m	£0.8m	£1.2m
Other Environmental	£0.5m	£1m	£1.5m

## Competition Impact

75. The loss of derogations will increase the price of fuel for pleasure boat use. This will reduce the volume of sales and the profit margin for suppliers initially, which will lead to a reduction in the number of suppliers. We welcome feedback on this conclusion

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

## Annexes

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