

Regulatory Impact Assessment (RIA)

Hydrocarbon oil duty: Changes to Excepted Vehicle Schedule

Purpose and intended effect

The policy objective

The purpose of this measure is to restore clarity and consistency to the schedule of excepted vehicles entitled to use rebated gas oil (“red diesel”). Entitlement to use of rebated gas oil on public roads will be restricted to those vehicles that only make incidental use of the road network; incidental use meaning journeys that are of brief duration or infrequent occurrence. This will remove perverse incentives to use less efficient vehicles, correct distortions to competition, and protect Exchequer revenues. Proposed changes should make the rules fairer and easier to understand, making it easier for industry to comply and for enforcement agencies to identify abuse.

Background

It has long been accepted that, where vehicles are not used on public roads or make only incidental use of public roads, paying the full road fuel rate of duty would impose a disproportionate burden. For this reason the use of rebated gas oil is permitted in excepted vehicles as defined by Schedule 1 to the Hydrocarbon Oil Duties Act, 1979 (HODA). Duty on rebated gas oil is more than 40 ppl below that charged on the principal road fuels. In addition, subject to certain conditions, a partial repayment of duty can be claimed on biodiesel used as fuel for an excepted vehicle. Excepted vehicles may also use road fuel gas without payment of duty. Entitlement to excepted vehicle relief is believed to be worth around £600 million to the sectors concerned.

The Government is concerned that the excepted vehicle schedule has failed to keep pace with changes in technology or commercial practice. Vehicle technology continues to evolve, and over time new types of vehicle (and modifications of existing types of vehicles) have come onto the market that had not been envisaged when the excepted categories were originally drawn up. Vehicle owners, enforcement agencies, Tribunals and the High Court have been called on to interpret the schedule in respect of such technological change on a case by case basis, and the result has been an inconsistency of approach. It has become increasingly unclear why some types of vehicle should benefit whilst others do not, and the ambiguity surrounding which vehicles should qualify has encouraged vehicle owners to interpret the rules to suit themselves and discouraged law enforcement agencies from taking action, resulting in a climate in which increasingly the law has become disregarded.

Rationale for Government intervention

The expansion of the schedule, the ambiguity in interpretation, and the resulting disregard for the law is resulting in revenue loss and distorting competition.

Rebated gas oil is not intended for use as a road fuel. The use of rebated gas oil on road is permitted to avoid placing a regulatory burden on vehicles where fuel is intended primarily for consumption off-road, but some incidental use of public roads also occurs. Incidental use in this instance refers to journeys of brief duration or infrequent occurrence. Where rebated gas oil is used on road more than incidentally, these businesses are not paying their fair share of the tax burden, which falls on other road users.

Furthermore, inconsistencies in the Schedule can mean that businesses with vehicles using rebated gas oil are able to compete unfairly with businesses that use vehicles paying the full road fuel rate of duty. This is exacerbated by the ambiguity in the schedule, which can lead to both unintentional misuse and to deliberate fraud and evasion. Enforcement action to counter this fraud and evasion then imposes a further regulatory burden on legitimate businesses, in the form of time lost from action taken by enforcement agencies to ensure compliance.

Road fuel fraud and tax avoidance is estimated to have cost the taxpayer around £600 million in 2004. The proportion of this fraud and tax avoidance that can be attributed to accidental or deliberate misinterpretation of the excepted vehicle schedule cannot be quantified, but what is clear is that the ambiguity in the schedule makes this one of the most difficult areas of road fuel fraud to tackle effectively. Clarifying the schedule would make it easier to identify and prosecute abuses, encouraging increased compliance. This in turn would release enforcement agency resources, enabling them to concentrate more effectively on other aspects of road fuel fraud such as tracking down and breaking up criminal fuel laundering gangs.

If the excepted vehicle concession is to remain viable, reform is therefore required. There is a need for a consistent approach to reduce the scope for ambiguity. As part of this process of reform, and in the light of the development of new and to some extent competing technologies, it has been necessary to re-examine the position not just of vehicles that have recently been brought into the schedule, but also of vehicles whose excepted status is longstanding, and indeed of vehicles that do not enjoy excepted status at present.

To provide a basis for this reform, the Government has outlined a principled framework, using the following five criteria:

- i. Is there a principled case for excepted vehicle status based on incidental use?
- ii. Would withdrawing excepted vehicle status impose a regulatory burden?
- iii. How would withdrawing excepted vehicle status affect competition?
- iv. Would withdrawing excepted vehicle status have an unacceptable distributive impact?
- v. Would withdrawing excepted vehicle status clarify the Schedule and in doing so improve compliance and enforcement?

Consultation

Within Government

The excepted vehicle schedule cannot be considered in complete isolation from other fiscal and regulatory concessions that influence behavioural decisions. HMRC has consulted the Department for Transport (DfT) to identify areas of common interest and will continue to work closely to realise mutually beneficial solutions, particularly in the area of vehicle excise duty.

The proposed approach to changes affecting the agriculture sector follows a partnership approach between Government and the farming industry, in line with the Government's Farm Regulation and Charging Strategy.

Public consultation

In December 2004 HM Treasury and the then HM Customs and Excise issued a consultation document on *Hydrocarbon Oil Duty: Consultation On Changes To Excepted Vehicle Schedule*. The consultation document set out the Government's analysis of the current position on excepted vehicles and consultation welcomed stakeholders' views on amending the schedule. In particular, views were invited in respect of the tractor, agricultural engine, mobile crane and road construction vehicle categories.

77 direct responses to the consultation were received, reflecting a wide range of views. Respondents included trade bodies, local authorities, businesses and private individuals. Industries represented included agriculture, forestry, haulage, plant-hire, road construction and equipment manufacture. In addition, 34 members of the Construction Plant-hire Association and 9 members of the Road Safety Marking Association wrote to their Members of Parliament to express concern at the consultation, and these letters were also been considered. A summary of responses to the consultation was published in December 2005. During and after the consultation period HMRC officials also held meetings with some of the organisations most likely to be affected by any changes. These included the National Farmers Union, the National Association of Agricultural Contractors, the Agricultural Engineers Association, the Freight Transport Association, the Construction Plant-hire Association, the International Powered Access Federation, the Road Surface Dressing Association and the Road Safety Marking Association.

The consultation contributed to the development of the principled framework for reform, and, together with subsequent discussions, played an important part in modifying proposed changes to the schedule, particularly in respect of mobile cranes and agricultural engines, and in identifying other areas where change was desirable, such as the creation of a new category for agricultural material handlers. Representations have also influenced decisions on timing, notably in respect of the road construction category, deletion of which has been delayed until 1 April 2008. Finally, trade organisations have had the opportunity to comment on revised definitions to ensure that these are fit for purpose.

Options

1. Do nothing.
2. To amend the excepted vehicle schedule.

Amendments to the excepted vehicles schedule are summarised below.

- **Unlicensed vehicles not used on public roads - amendment of existing category**

Vehicles licensed after 31 January 1998 require a Statutory Off-Road Notification (SORN) if kept off-road. Such vehicles will be eligible to use red diesel only if such a declaration has been made. Unlicensed vehicles that do not require a SORN will continue to be able to use red diesel without making a SORN declaration. This reflects HMRC's current administrative practice of considering enforcement action where a declaration is required and has not been made.

- **Tractors – amendment of existing category**

This category will be limited to purpose-built off-road tractors used for purposes relating to agriculture, horticulture or forestry, or for cutting hedges and verges. HM Revenue & Customs and industry representatives have agreed that they will jointly establish and publish a code of practice that defines purposes relating to agriculture, horticulture or forestry.

- **Agricultural engines – amendment of existing category**

This category will be limited to purpose built agricultural machines that do not carry or tow any load other than is necessary for the operation of their built in machinery. This category includes, but is not limited to, combine harvesters, crop sprayers, forage harvesters and pea viners.

- **Vehicles used between different parts of land – amendment of existing category**

The category will be restricted to vehicles licensed for limited use under the Vehicle Excise and Registration Act 1994. This reflects HMRC's current administrative practice of considering enforcement action where owners do not hold such a licence.

- **Mobile cranes – amendment of existing category**

This category will be limited to mobile cranes, including truck mounted access platforms, with a revenue weight exceeding 3.5 tonnes.

- **Road construction vehicles – deletion of category**

The road construction vehicle category will be deleted.

- **Agricultural material handlers – new category**

A new category will be introduced to capture material handlers used solely for purposes relating to agriculture, horticulture or forestry or for cutting hedges and verges.

- **Agricultural processing vehicles – new category**

A new category will be introduced to capture mobile seed and feed processing machines. These vehicles were formerly included in the agricultural engine category.

- **Mobile pumping vehicle - new category**

A new category will be introduced to capture boom mounted concrete pumps. These vehicles were formerly included in the mobile crane category.

- **Road surfacing machines – new category**

This category will be limited to purpose-built heavy plant, such as asphalt pavers and chipping machines, which formerly qualified under the road construction category.

- **Tar sprayers – new category**

This category will be limited to tar sprayers, which formerly qualified under the road construction category.

Costs and benefits

Sectors and groups affected

Amending the existing tractor and agricultural engine categories, and introducing new categories for agricultural material handlers and agricultural processing vehicles, would primarily affect the farming, agricultural contracting, and agricultural equipment manufacturing sectors. The changes are intended to ensure that definitions are flexible enough not to stifle innovation in the agricultural sector, but robust enough not to open up potential loopholes. The Government is concerned that all policy is “rural proofed”, and is working with the industry to reach a common understanding of the circumstances that constitute legitimate use of tractors for purposes of agriculture, horticulture or forestry.

Amending the existing mobile crane category would primarily affect the plant-hire, construction and utilities sectors. The mobile crane category would continue to include truck mounted access platforms, but would be restricted to vehicles with a revenue weight exceeding 3500 kilogrammes, and would clarify what equipment can be carried. Boom mounted mobile concrete pumps would no longer qualify as mobile cranes, but would continue to qualify as excepted vehicles under the new mobile pumping vehicle category. The effect would be to remove around 1300 truck mounted access platforms with a revenue weight not exceeding 3500 kilogrammes from the schedule, and to close potential loopholes.

Deleting the road construction category and replacing it with the more limited road surfacing machine and tar sprayer categories would primarily affect public authorities responsible for road construction and maintenance, plant-hire companies and companies engaged in road construction and maintenance activities, including road surface dressing and road safety marking. The effect would be to remove from the schedule vehicles adapted for a wide range of activities relating to road construction, including surface dressing, pothole repair, safety marking, street signage, barrier installation and street lighting.

Benefits

Option 1: Do nothing.

Under this option there would be no additional costs to industry.

Option 2: To amend or delete categories.

Under this option the benefits would be:

Up to date definitions which reflect changes in technology and commercial practice. The intention is to set revised definitions that are flexible enough to accommodate technological innovation. In the case of agricultural material handlers it is accepted that the flexibility provided by this fast evolving technology, coupled to the increasingly dispersed nature of farm holdings, justifies the introduction of a new excepted vehicle category.

Unambiguous definitions which will facilitate compliance by vehicle owners and policing by enforcement agencies. The changes to the schedule are intended to increase clarity and make it easier for businesses to comply and for enforcement agencies to identify and stamp out abuse. The road construction category in particular causes considerable confusion, and much enforcement agency time is spent investigating possible abuses, with corresponding roadside delays for vehicle operators. A range of vehicles is adapted for a wide variety of different purposes relating to road construction, most of which make extensive use of public roads. In some cases such adaptations are permanent, extensive and obvious, and make the vehicles unsuitable for any purpose other than road construction, but more often this is not the case. In some cases, such as lorries fitted with an hydraulic ram for installing safety barriers, adaptation will be minimal; in others, such as tipping lorries used in chipping, the adaptation will be temporary and easily reversed; in still others, such as road sweepers fitted with special brushes, it will be difficult to ascertain whether any adaptation has been made at all; and in some cases, such as van mounted access platforms used in street lighting, the adaptation would make them suitable for a range of non-qualifying uses. The simplest and fairest way of addressing this problem is to delete the road construction category and replace it with a new road surfacing category restricted only to vehicles which genuinely make incidental use of the public road and which can be defined without ambiguity. Similarly, changes to the tractor, agricultural engine and mobile crane categories are intended to remove any doubts about which vehicles can qualify.

The removal of distortions in competition. Inconsistencies in the schedule can mean that businesses with vehicles using rebated gas oil are able to compete unfairly with businesses that use vehicles paying the full road fuel rate of duty. This is exacerbated by the ambiguity in the schedule, which can lead to both unintentional misuse and to deliberate fraud and evasion. There is evidence of companies gaining a competitive advantage, whether deliberate or unintentional, from the misinterpretation of the rules, particularly in the road construction sector. Removing the road construction category would facilitate a level playing field. The proposed joint industry code, setting out which uses are accepted as being for purposes relating to agriculture, horticulture or forestry, is intended to prevent tractors using rebated gas oil from competing unfairly for haulage work.

The removal of a financial incentive to use less safe and more polluting vehicles on road. Tractors designed for use off road can represent a safety hazard when used on road, particularly if not properly maintained. The proposed code, setting out which uses are accepted as being for purposes relating to agriculture, horticulture or forestry, is intended to discourage the use of tractors on road in circumstances where other vehicles could be used. Most rebated gas oil does not at present conform to road fuel quality standards, and its use as road fuel is not to be encouraged, particularly in built up areas.

Restoration of lost revenue to the Exchequer. The proposed changes to the schedule are intended to remove vehicles that make more than incidental use of public roads. Rebated gas oil is not intended for use as road fuel and, where it is used on road more than incidentally, these businesses are not paying their fair share of the tax burden, which falls on other road users. It is estimated that these changes to the schedule will result in a revenue gain of around £10 million per year. In addition these changes will support HMRC in meeting its target under the UK Oils Strategy to reduce oils fraud as a share of the England, Wales and Scotland diesel market to 2% by March 2006, and maintain it thereafter.

Costs

Option 1: Do nothing.

Under this option, there is no compliance burden on the industry as a result of this measure or fiscal costs to the Exchequer. However, the identified problems with the current schedule would continue.

Option 2: To amend or delete categories.

Under this option, any additional compliance burden on the industry as a result of this measure would be negligible.

The impact of paying the higher duty rate will vary considerably by sector, depending on the number of vehicles affected and the proportion of costs this represents.

In the **agriculture sector**, the approach adopted is intended to remove the scope for abuse whilst minimising the imposition of additional regulatory burdens. Costs should therefore be minimal.

In the **plant-hire sector**, the consensus seems to be that the additional cost of the fuel would typically increase hire costs by around 15% for those vehicles affected. This additional cost would be passed on to clients. Types of vehicles affected are those that would formally have qualified under the road construction category and truck mounted access platforms with a revenue weight not exceeding 3500 kilogrammes. In the latter case many are hired out as self-drive vehicles and users will already be paying the full road fuel rate.

In the **road surface dressing sector**, the cost of fuel could have an impact on progress towards achieving national road condition targets. Road surface dressing is used to extend the life of the pavement and restore skid resistance on the secondary network. This is a process used almost exclusively by local authorities. Where direct labour is used the cost will be borne by local authorities, but where contractors are used these may not be able to pass on costs. Rural authorities are more likely to have extensive secondary road networks and to use direct labour for road surface dressing. Road rollers and front end loaders are unaffected by changes to the schedule and will continue to be able to use rebated gas oil, and, following representations, chipping machines and tar sprayers will also continue to be able to use rebated gas oil, since it is accepted that these make only incidental use of public roads and do not represent an enforcement problem. Tailboard chippers and roadsweepers used in road surface dressing will lose the right to use rebated gas oil. Around 200 vehicles will be affected.

Road safety marking vehicles play a role in achievement of Government targets relating to congestion and casualty reduction. In the road safety marking sector, the additional cost of paying the full duty rate on road usage has been estimated by the industry as increasing costs by 12.5%, costing the industry approximately £4 million. There could also be additional costs as a result of installing additional fuel tanks to vehicles to enable auxiliary equipment to continue running on rebated gas oil. The industry estimate the cost of installing an additional fuel tank to be around £3,000 per vehicle, adding a total one off cost of £900,000. In most cases this cost would not be recoverable from their public sector clients, and there is a risk that, where costs can be passed on, pressure on local authority budgets would result in a reduction in work on the road-marking infrastructure. The industry are concerned that this could have an impact on the viability of businesses in the sector. Deletion of the road construction category is therefore to be delayed until 2008 to give the industry additional time to adjust. Any financial impact on local authorities will be considered as part of the Comprehensive Spending Review.

Small Firms Impact Test

Excepted vehicles are used by businesses of all sizes. Responses to the consultation from small firms were mixed. The extent of the impact of any change will depend less on the size of the business per se, than on the proportion of costs represented by vehicle fuel, and the extent to which they are in competition with other businesses using fuel dutied at a different rate. The impact is therefore expected to be highly variable, but should not fall disproportionately on smaller firms.

Competition assessment

In the markets affected by the regulation, no one business has a dominant market position, and the cost of the regulation should be evenly spread within each sector. The regulation is not expected to have an impact on the structure of the market, or on the ability of new firms to compete. This is an area characterised by rapid technological change, and the impact on competition from this measure relates less to directly equivalent businesses than to competing technologies. Proposed changes are intended to remove distortions in competition, by removing entitlement to relief where this enables businesses to undercut competitors by using cheaper fuel.

Enforcement, sanctions and monitoring

Existing sanctions for non-compliance will continue to apply. For misuse of oil (other than fully duty paid fuel) for use as fuel in a road vehicle, a penalty of £250 may be imposed for each offence and the duty rebate recovered. The vehicle may be seized and forfeited, and if dishonesty is involved, a penalty of up to 100% of the duty evaded may be imposed.

Implementation and delivery plan

The policy will be implemented by The Excepted Vehicles (Amendment of Schedule 1 to the Hydrocarbon Oil Duties Act 1979) Order 2006 and by guidance to be published by HM Revenue and Customs.

Post Implementation Review

HMRC will conduct a post implementation review to ensure that the relief is meeting its objectives and that there are no unforeseen consequences

Summary and recommendations

Option 2 is chosen as it is considered necessary to restore consistency and clarity to the schedule. This will bring definitions up to date with changes in vehicle technology and commercial practice, facilitate compliance by vehicle owners and policing by enforcement agencies, remove distortions in competition, and discourage the use of less safe and more polluting vehicles on road.

The most significant impact is expected to be on the road construction sector. Deletion of the road construction category is to be delayed until 2008 to give the industry additional time to adjust. Any financial impact on local authorities will be considered as part of the Comprehensive Spending Review.

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Declaration

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

JOHN HEALEY MP
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