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PARTIAL REGULATORY IMPACT ASSESSMENT FOR HYDROCARBON OILS DUTY - EXPIRY OF DEROGATION

HYDROCARBON OILS DUTY – EXPIRY OF DEROGATION ALLOWING THE UK TO APPLY RATE OF DUTY TO DIESEL USED IN PRIVATE PLEASURE BOATS

Purpose and Intended Effect of Measure

The Policy Objectives

21.1 The purpose of this document is to gauge the regulatory impact of charging the full rate of excise duty on diesel used to power private pleasure boats. The UK currently allows rebated gas oil (“red diesel”) to be used in pleasure boats, and this bears a reduced rate of duty of 6.44 pence per litre compared with 47.10 pence per litre for unrebated diesel (ultra-low sulphur diesel – ULSD – or sulphur-free diesel – SFD) used on the roads.

21.2 This partial RIA is concerned solely with private pleasure boats. The use of red diesel in commercial craft would be unaffected if the derogation were not renewed, and full relief from duty would continue to be available for commercial marine voyages under Marine Voyages Relief. Red diesel would also continue to be available for a range of other uses, including heating applications, stationary plant, generating sets, diesel locomotives and certain categories of ‘excepted vehicle’.

21.3 On accession to the European Union, the UK policy of charging the reduced rate of duty for diesel used in pleasure craft was allowed to continue under derogation from the relevant EU Directives (initially the Oils Structure Directive (92/81/EEC), which was replaced by the Energy Products Directive (2003/96/EC)). The derogation was originally due to expire in 2001 but was extended for a period of five years.

21.4 The UK is one of five Member States with derogations under the Energy Products Directive permitting the use of red diesel in private pleasure craft, the others being Ireland, Belgium, Finland and Malta. The derogations held by Member States under this Directive are due to expire at 31 December 2006. If a Member State wishes to renew a derogation, a formal request must be made to the European Commission; the procedure is then for the Commission to make a proposal to the EU Council of Ministers, where approval requires unanimous consent.

21.5 The Commission has expressed the view that, unless Member States can show that renewal is in the interest of reducing distortion of competition, promoting the better operation of a single market or protecting the environment, derogations should not be renewed.

21.6 The Government has considered the effects of not applying for renewal of the derogation against the grounds which the Commission has given. The Government has also considered regional impact and health and safety aspects, which it considers relevant in deciding whether or not to apply for renewal of this derogation.

Consultation

21.7 The policy has been developed taking into account views gathered informally from stakeholders in UK boating, including the British Marine Federation (BMF), the

Inland Waterways Association (IWA), the Royal Yachting Association (RYA) and the Federation of Petroleum Suppliers (FPS). Other Government departments, such as the Department for Trade and Industry, have also been consulted. All of these bodies have provided evidence, which has been used in producing this assessment.

21.8 It is intended that this assessment will continue to be developed in the period leading up to the expiry of the current derogation.

21.9 Most stakeholders have expressed support for the retention of the derogation and hundreds of private boat owners have written to Ministers supporting retention of the derogation. The RYA, BMF, IWA and FPS have united to provide one document produced in July 2005 (“Seeing Red” – the campaign for the retention of the current derogation on use of red diesel), which they have used in arguing for extension of this derogation.

21.10 The arguments include the serious impact that removal of the derogation would have on boat usage, regional economies and tourism, and the UK marine industry. In addition, it is suggested that both the industry and HM Revenue and Customs would face compliance problems if the derogation ended, and that there might also be environmental and health and safety implications (assuming that boat owners changed to petrol engines or that waterside diesel became less readily available).

21.11 A few individuals have, however, responded in favour of removing the derogation, arguing that allowing the use of red diesel is an unjustified subsidy for a hobby, which encourages the use of high horse power, deep displacement craft with high fuel consumption.

Options

1. Allow the derogation to lapse and require pleasure boat users to use conventional road diesel ((ULSD or SFD)

21.12 Under this option, there would be a small gain of revenue to the Exchequer but extra compliance burdens on the industry and HMRC in collecting any duty.

Apply for renewal of the derogation to allow the UK to permit the continued use of rebated oils in pleasure boats for a further period of 5 years

21.13 Under this option, the UK would not be required to make any legislative or administrative changes to the current system of duty on diesel used for pleasure boats. The potential revenue from applying the full rate of duty would, however, be forgone.

Benefits

1. Allow the derogation to lapse

21.14 Under this option, HM Treasury estimate that there would be an increase in revenue of £10m a year, but only if the sale of waterside diesel were unaffected. The revenue increase would depend on the size of the behavioural effect from the increase in the duty. An RYA Survey indicates that up to 54% of all boat owners who currently use red diesel might give up boating altogether. The most significant behavioural effect

would come from owners of motorboats, where it is estimated that up to 72% of participants might give up boating.

2. Apply for renewal of the derogation

21.15 This is the option adopted. The Government believes that removal of the derogation would result in unacceptable compliance costs. It also believes that, on balance, the environmental, social and market effects of ending the derogation would also be detrimental.

Costs

1. Allow the derogation to lapse

21.16 Under this option, the Government believes that the compliance costs from ending the derogation would be likely to be an unacceptable burden on three groups due to:

- costs to pleasure boat users;
- costs to the fuel suppliers; and
- costs in administration and enforcement for HMRC.

Costs to Pleasure Boat Users

21.17 The BMF estimates that there are approximately 463,000 boats over 2.5 metres in the UK, of which approximately 349,000 are motor boats and therefore rely solely on engines for propulsion, albeit consumption can vary enormously between different types of boat, and that many smaller craft will in any case be using petrol and therefore will already pay the full road fuel duty rate. Many boats are now also fitted with diesel-powered heaters.

21.18 The use of rebated fuel to provide heat and light on boats would still be permitted. Boats kept on the inland waterways are often used for residential purposes or long term cruising, and will typically use more diesel for heating and lighting than a boat kept on the coast. The Residential Boat Owners' Association have recently carried out a survey, which suggests that there are approximately 15,000 residential boats in the UK, mostly on inland waterways. For these boats, they suggest that the average yearly usage of diesel is 1200 litres. Of that amount, over 60% is on average used to provide heat and light.

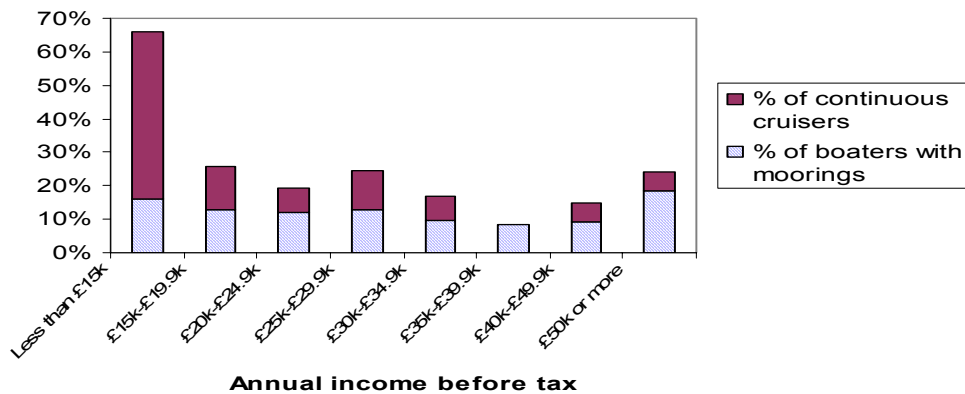
21.19 If boat owners wished to continue to use red diesel, they would have to add an extra tank: one for fuel to propel the boat, and another for fuel for other purposes such as cooking, heating and lighting. The cost would vary depending on the size and design of the boat, but it is estimated to be in the region of £750 for a typical inland cruiser. In some cases the technical aspects of installing a new tank might give rise to increased costs, and the design of a vessel might inhibit the installation of an additional tank.

21.20 If a separate tank system were not installed, the extra cost to homeboat owners of unrebated fuels used for purposes for which they were not entitled to use red diesel is estimated as on average £300 a year (i.e. average use of almost 720 litres of fuel per year for non-propulsion purposes multiplied by a difference of 40.66 pence per litre between red diesel and ULSD). The total cost to homeboat owners, who form only a small proportion of pleasure boat users, could be as much as £4.5 million a year. Other boat

owners could, of course, refit their boats with twin tanks, but on average this would cost approximately £750 for a typical inland cruiser.

21.21 Given that the proportion of inland boat owners on low or reduced incomes is far greater than for boat owners as a whole, the costs of fitting a new tank would have a disproportionate effect on the inland waterways sector, including inland tourism. A sample survey by the British Waterways Board, to which 1769 boat owners replied in 2004, showed that the majority of boat owners with continuous cruisers earned less than £15,000 a year before tax, while the majority of boat owners with moorings lived below the average household income rate – see the table below for further details.

Chart 21.1 Comparison of Household Income



Costs to the Fuel Suppliers

21.22 There would be a cost for marinas and small ports that currently service boats using rebated oils only. As noted above, commercial boats, which use the bulk of marine fuel, are entitled to use rebated fuels. At present, therefore, suppliers need stock only one type of fuel. If, however, pleasure boats had to use unrebated fuel, suppliers would face the choice of either:

- not installing extra fuel tanks and pumps and therefore forgoing either the pleasure boat or the commercial market; or
- installing extra pumps and tanks that would allow them to supply both markets.

21.23 A BMF survey of the effects on leisure diesel suppliers of removing the derogation indicated that, of 114 companies who responded to the survey, 24% would install new pumps and tanks to accommodate two fuels, 32% would continue to stock rebated fuels only, and 44% would switch over from supplying red diesel to ULSD. There would be different costs for each of these groups.

Those Opting not to Supply ULSD

21.24 The cost for this group would be lost business in terms of being unable to supply fuel to the pleasure boat market. The impact on the 36 businesses in the BMF survey is estimated to be on average £158,774, which equates to £5,715,864 in total. The survey represents a small fraction of those companies potentially affected.

Those Opting to Supply Only ULSD

21.25 For this group there would be two costs. First, in order to move from supplying red diesel to ULSD, they would have to have their tanks commercially cleaned to remove traces of red diesel. The BMF estimate that the cost of such cleaning would be over £1000 for each tank, however, one BMF member had a recent quotation for £2,500 per tank. Although tanks can be de-contaminated, the general consensus is that the red dye of the diesel could never be removed completely, and this raises issues for testing and enforcement.

21.26 Secondly, there would be additional costs because the fuel would be more attractive to fraudsters than red diesel. Fraudsters will usually remove the dye from red diesel in order that the fuel can be used in road vehicles. However, as this costs time and money, obtaining and selling ULSD is more attractive and profitable for fraudsters.

21.27 Many businesses proposing to supply ULSD might therefore have to increase their security considerably in order to protect themselves from this threat. It is difficult to get an indication of cost as security measures will vary, but the BMF estimate between £1000 and £5000 depending on the sophistication of the system installed (which might include fencing, CCTV, and alarms). In addition, the FPS estimate that there would be a recurring cost of £500 per month.

21.28 Commercial diesel users could potentially use ULSD supplied by these outlets and claim back the duty paid as they currently do with rebated fuel. However, since the fuel used would now carry a duty rate of an extra 40 pence per litre, there would be a cost to them in terms of loss of cashflow from the time of payment to receipt of a refund from HMRC.

21.29 The cashflow could be significant depending on whether the boat was a small fishing boat under ten metres, which will use on average 1,000 litres of fuel a week, or a trawler over 15 metres long, which will use on average over 9000 litres a week. The cashflow loss for a small boat would potentially be £406 a week, while the potential loss for a trawler would be almost £3360 a week. It is unlikely, therefore, that commercial users would buy ULSD in these circumstances, leading to a loss of business for suppliers. Commercial boat owners would also lose out in that the number of locations where they could refill their tanks would be reduced.

21.30 The higher retail cost of ULSD might mean that some businesses would be unable to obtain sufficient credit to secure a supply. The choice of suppliers might also be restricted as many oil distributors no longer deal in road fuels because of the poor margins and high credit risks. This problem is perhaps more significant in the UK than other Member States with have lower duty differentials between road fuels and off-road fuels.

Those Opting to Supply Both ULSD and Red Diesel

21.31 Although this group would not suffer any loss of trade, it would face additional costs for installing new tanks and pumps for the second fuel. The estimated cost of adding a tank is £20,000 (consisting of £12,000 for the tank, £6,000 for the pump and £2,000 for installation). In addition, installation of ULSD would also have a potential opportunity cost in that space in marinas is often limited and the space taken by additional tanks could, for example, have been used as berthing for a boat. There would also, as mentioned above, be potential additional costs in terms of providing extra security for the fuel.

21.32 In some locations it might not be possible to install additional tankage, so this option would not be available. In addition, the cost of planning applications might be significant. Such applications typically cost around £200, with additional costs of engaging a planning adviser and preparing detailed plans. Capacity for an extra tank is a major issue and could also have safety implications.

21.33 The BMF survey of fuel suppliers suggested that 92% of those who had replied to the survey believed that the removal of the derogation would have a detrimental effect on their business. Of the 114 companies who replied, 94 gave an estimate of the loss to them, in terms of both business lost and additional costs. The figure for this group alone amounted to £9.7 million, which represented 15% of these companies' turnover. The removal of the derogation would therefore have a significant financial impact on these companies.

Costs to businesses and HM Revenue and Customs in terms of extra compliance costs

21.34 HMRC would face additional assurance costs if the derogation were removed. At present, suppliers of rebated fuels are registered by HMRC in their Registered Dealers of Controlled Oils scheme (RDCO). This places requirements on dealers to maintain records of purchasers of rebated fuels and the purpose to which they are put in order that misuse can be more easily detected.

21.35 The net effect of removing the derogation would be that some of those currently registered under the RDCO scheme would stop supplying rebated fuels and therefore there would be a small compliance saving for these suppliers. However, there would be additional assurance costs for HMRC in those instances where suppliers decided to supply rebated and unrebated fuels alongside each other. Since this would greatly increase the possibility of misuse or fraud, HMRC assurance would therefore have to be much tighter than if just one fuel were being supplied.

21.36 Prevention of misuse would also be made much harder for HMRC if boat owners installed two tanks. Records could show that a boat filled up with both fuels, but whether or not the rebated fuel was being used properly could not be established from this information alone. At present, pleasure boats are a low fraud risk for HMRC in that they are entitled to use red diesel.

21.37 If that entitlement were removed, pleasure boats in the UK would become an additional fraud threat and HMRC would have to spend more resources in ensuring that red diesel was not misused. HMRC estimates that it would need five extra staff to check compliance at a cost of approximately £250,000 a year. It would also have to invest in additional testing equipment for sampling fuel from boats.

21.38 In addition, it would be difficult for HMRC to establish clearly whether there had been fraud. A boat might legitimately have traces of red diesel in its engines subsequent to the removal of the derogation for a number of reasons that would make prosecution difficult. Pleasure boat users could, for example, claim that:

- The fuel had been purchased in the UK before the expiry of the derogation. Since many pleasure boat owners are only occasional users and use is seasonal, a lot of boats would be laid up in harbour if the derogation expired on 31 December 2006. It might then be 2-3 months before owners used their boats again, so that many boats would have rebated fuels in their engines for many months after the end of the derogation.

- Traces of red diesel found after expiry of the derogation would not necessarily demonstrate misuse but simply that red dyes took a long time to clear from engines. The only way of tackling this issue would be to require all pleasure boat owners to clear their tanks of rebated fuels before 1 January 2007 and then to have their engines industrially cleaned so that there were no traces of red dyes left in the engine.
- However, as with the land tanks, the general consensus is that even with industrial cleaning, remnants of the red colour would be impossible to remove completely. Given that there are approximately 350,000 pleasure boats over 2.5 metres in the UK, the cost of such an operation could exceed £1.5m (assuming all these boats had a diesel engine and that it would cost on average £500 to clean a tank). The Government would not fund such cleaning, and it would have a disproportionate effect on boat owners who were retired or on low incomes. There would also be a high risk of marine pollution as a result of flushing out tanks.
- Boats could take on fuel in the Channel Islands. The Channel Islands are outside the EU, but could continue to supply gas oil from UK refineries that has had fiscal markers added. Thus traces of dyes in engines would again not necessarily prove that there had been misuse of rebated fuels.
- Boats could also have changed uses; for example, a boat that had been used for commercial purposes would legitimately have used red diesel, but if it were then used as a private pleasure craft, rebated use would be prohibited although traces of dyes would still remain in engines. Effective enforcement by HMRC would be all the more difficult because boats chartered without crew for private use would not be allowed to use rebated fuels, although rebated fuel use would be permitted if the same boat were chartered with crew. HMRC would therefore face the additional assurance difficulty of ensuring that any claims for repayment of duty for commercial use were genuine.

2. Apply for extension of the derogation

21.39 The main cost of renewing the derogation would be the loss of potential revenue from use of ULSD rather than rebated fuel by pleasure boat users. The potential revenue gain from ending the derogation is estimated to be £10 million a year at most, but it is unlikely that this amount of revenue would be collected in practice, because the removal of the derogation would be likely to reduce pleasure boating activity in the UK.

21.40 As noted above, the RYA survey suggested that 54% of those who replied would consider giving up boating altogether if the derogation were removed. There might also be increased 'cross-border' shopping, particularly on the south coast, where owners of fast motor cruisers with large fuel capacity could fill up with cheap diesel on the other side of the Channel. Others might consider relocating their boats permanently outside the UK, taking advantage of generally lower costs and the availability of cheap airfares.

21.41 While the estimated extra revenue does take into account some reduced fuel use due to the increase in duty, it is difficult to estimate the full effect on consumption of not renewing the derogation, but clearly the more boat owners gave up boating or purchased fuel from outside the UK, the lower the revenue gain would be.

21.42 Loss of diesel sales from those who claim they would definitely stop purchasing diesel could result in potential revenue loss to the Government of approximately £2.5 million. The RYA survey estimates that if all those who claim they would potentially or definitely stop purchasing diesel actually follow through with their intention, there would be a potential loss of revenue of approximately £0.5 million

21.43 The BMF survey “BMF European Overview 2004” also estimates that spending by boat owners, currently estimated at £700 million per year, is likely to fall to an estimated £550 million if there is a decrease in participation and boat usage as suggested in the “Seeing Red” report.

21.44 There are around 5000 businesses in total that might be affected by changes in boating participation and behaviour, so that the detrimental impact could extend beyond the marine industry, with implications for job losses, resulting in the loss of tax revenue. When this is offset against the cost of enforcement, it can be argued that, while ending the derogation might raise negligible sums, it would be more likely to reduce revenue to the Exchequer.

21.45 In addition, the leisure marine industry is currently a UK manufacturing success story. Over the past five years it has grown by 36%, according to the BMF. However, the economic impact of losing the derogation would put the whole sector under threat, including boat builders, chandlers, holiday companies and marinas.

Competition Assessment

21.46 To some extent the fuel supply network at ports has grown up as a niche market to serve pleasure boats. Those companies involved in supply are often very small enterprises, sometimes being set up as associations or clubs to serve their members. They would therefore be disproportionately affected by the removal of the derogation.

21.47 It is likely that many companies might withdraw from supplying fuel if the derogation expired (see reference above to the BMF survey of fuel suppliers). This would therefore distort the current market further by reducing the number of suppliers at ports and harbours. Smaller companies that remained in the market would be unable to compete with the oils majors who supply ULSD to their forecourts, and would lose business as pleasure boat owners looked to forecourts for fuel supply. This would have a number of undesirable side effects:

- it would mean that fuel was travelling longer distances than before if owners were transporting it from major forecourts to their boats;
- the carriage of fuel in this way would have health and safety implications, particularly if it were transported in inappropriate containers; and
- it would increase the possibility of leakage of diesel into the waterways if it was being decanted by owners into boats rather than through pumps.

21.48 There might also be detrimental environmental effects from boats carrying heavier loads of fuel, and therefore consuming more fuel, because there would be likely to be fewer fuelling sites available to them after the end of the derogation. The BMF survey showed that in some areas of the UK there was a distance of 70 miles between one fuelling point and the next. The BMF found that there might be almost a third fewer suppliers of fuel for pleasure boats if the derogation ended, so that this problem would be exacerbated.

21.49 Given the geographic and demographic features of the UK (where there are many long stretches of coastland with few inhabitants and consequently supporting fewer businesses), this would be a particular problem for pleasure boat owners in areas such as Cornwall, Scotland, Wales and Northern Ireland, where there are already few refuelling points.

Effects on the Scottish Coast

21.50 The Royal Scottish Motor Boat Club (RSMC) provided a report in July 2005, which looked at the effects of removing the derogation on Scotland and this provides a useful example of the problems that removal of the derogation might cause in some of the more remote and rural areas of the UK which have long, sparsely populated coastlines. As the report pointed out, there is a distance of some 480 miles from Largs at the bottom of the West Coast to Portree, a port in Skye, at the top of the West Coast.

21.51 Along that coastline, there are fewer fuel sites further north, away from the major conurbation around the Clyde, which contains Glasgow. The distances between refuelling locations also are significant. After Oban, for example, it is 25 miles to the next refuelling site at Tobermory, then after that a further 32 miles to the next site at Mallaig, then another 20 miles to Kyle of Lochalsh and then another 20 miles to Portree. These distances might become greater since some sites would not stock conventional diesel if the derogation ended, owing to the costs.

21.52 The RSMC report cites the refuelling site at Kyle of Lochalsh as an example, with having estimated costs of £20,000 to fit conventional diesel pumps and tanks. The refuelling site has decided that it would therefore not provide conventional diesel and would only provide red diesel for commercial users. The report also shows that, even in the Clyde area, where there are currently seven suppliers of fuel to pleasure boat owners, two of these suppliers are unlikely to stock conventional diesel in the event of the derogation ending and indeed, since the remaining five locations will be marinas, their opening hours may be limited.

21.53 In addition, because of the small population along these coasts, there are few filling stations even for road vehicles; in the North of Scotland, there may be distances of 50 miles between filling stations.

Market Distortion

21.54 The removal of the derogation could cause market distortions in encouraging many UK boat owners to base their boats in other Member States. The RYA survey indicates that 51% of respondents said they would consider keeping their boat abroad if the derogation were not renewed. Within that group, a greater proportion of owners of more expensive motorboats would be likely to remove their boats, while less well off boat owners who might be unable to afford to resite their boats would be hit harder.

21.55 In addition, there would be further market distortions as cross border shopping for fuel would be more attractive (e.g. it would be more attractive to go to the Channel Islands, France or Ireland to restock with cheaper fuel than it is at present). The boat owners who would be likely to move their vessels abroad typically use much more fuel than average - about 5,000 litres a year. The UK would therefore lose the largest consumers of fuel overseas, and this could lead to a reduction in the revenue raised.

Equity and Fairness

21.56 It could be argued that the current derogation gives unfair advantages to pleasure boat owners, who, unlike motorists, pay a reduced rate of duty for their fuel. Nevertheless, a more accurate comparison would be between commercial and private boats rather than private boats and private motorists. As commercial boats are able to reclaim all duty paid on fuel they use this seeming benefit for pleasure boat owners is not in fact as great as it might appear

Small Firms Impact Test

21.57 The relief benefits users of diesel in pleasure boats, but the majority of companies in this sector are very small. The “Seeing Red” survey, for example, suggests that “ the marine leisure industry is predominantly comprised of small and medium-sized enterprises”. Indeed, many are small family owned companies. The effects of ending the derogation might well prompt many to abandon this market altogether, in particular given the extra compliance costs which would prove onerous for most of them.

21.58 The impact of the loss of the derogation on all diesel suppliers surveyed by the BMF represented 15% of their combined turnover, but there would be a disproportionate impact on smaller companies: for those with a turnover of under £100,000 it would be 39%; and for a company with a turnover under £200,000 it would be 26%.

21.59 The RSMYG report gave an example (mentioned earlier) of a fuel supplier in Kyle of Lochalsh who faced costs of an estimated £20,000 to install additional tanks and pumps to supply two grades of fuel. Given the limited turnover of the business, it was decided that such an investment was not practicable.

21.60 In addition to those directly involved in boating, there are many other associated smaller businesses that would be badly hit by the ending of the derogation. In some ports, for example, following the decline of the UK fishing industry there has been a deliberate attempt to build up businesses aimed at serving pleasure boat owners to replace the trade lost from the fishing industry.

21.61 The RSMYG report mentions, for example, how the Isle of Muck has established a restaurant in its community hall to serve pleasure boat visitors. If the derogation were to end, these and many other small businesses serving this market would be badly affected. In Norfolk, for example, there are many small companies that hire out holiday boats for use along the canals.

21.62 The “Seeing Red” survey estimated that the effect of losing the derogation would lead to an extra £50 a week on average being added to the costs of a canal holiday, which would make these holidays significantly less competitive and thus reduce demand. The costs would be even higher for a boat travelling around the west coast of Scotland - the RSMYG report estimated that the cost of a two week cruise on a forty foot motor cruiser would increase by over £1,000, and a weekend cruise from Largs to Tarbert would increase by £175, if the derogation ended.

21.63 In addition, any decline in the use of inland waterways by pleasure boats could affect many small businesses along the waterways, such as restaurants, public houses, and small shops.

21.64 A number of charities and voluntary organisations might also be affected disproportionately by the ending of the derogation. There are for example a number of organisations that teach children and young adults how to sail, and some of these offer socially deprived children the chance to holiday on a boat.

21.65 The National Community Boat Association (NCA), for example, is an umbrella organisation representing 97 charitable organisations who use their boats to give holidays to the socially excluded. In 2003, for example, this group provided over 200,000 passenger days, mostly on internal waterways, for the socially deprived. The NCA have said that small charities, such as their members, will be hit particularly by the ending of the derogation since they have limited and fixed incomes, often based on grants.

Enforcement, Sanctions and Monitoring

21.66 HMRC believes that removal of the derogation would necessitate extra resources for assurance. It would increase the risk of fraud or misuse at many fuel suppliers who would have two types of fuel for sale alongside each other. In addition, the policing of this change in legislation would be difficult since, as pointed out above, it would be difficult to detect misuse, given that there are a number of legitimate reasons why dye from rebated fuels might be found in pleasure craft subsequent to the expiry of the derogation.

Implementation and Delivery Plan

21.67 In the event of the derogation not being renewed, HMRC would publish guidance on how they would deal with this issue, and what transitional arrangements would be put in place.

21.68 If fuel suppliers elected to supply both rebated fuel and ULSD, any new storage tanks would have to comply with the Control of Pollution (Oil Storage) (England) Regulations 2001 (similar regulations are to be introduced in Scotland, Northern Ireland and Wales) which require larger and more expensive tanks than were previously permitted. Planning permission would also be needed, which can typically take up to 18 months to complete. It is likely that planning permission for additional fuel tanks will be a more sensitive issue than previously as a reaction to the Buncefield incident.

Post-implementation Review

21.69 If the derogation is extended, it is likely to be for a maximum of five years. HMRC would work with the industry during that period to review the justification for any further extension.

Summary and Recommendation

21.70 The Government believes that the balance of advantage lies with retaining the derogation. Its removal would cause market distortion and would have significant compliance costs for both the industry and the Government. In addition, Annex A lists other factors that have influenced the Government's decision to apply for renewal of the derogation.

Annex A - Additional points considered in deciding that the UK should request renewal of the derogation allowing the use of rebated fuels in private pleasure craft.

HEALTH AND SAFETY ISSUES

Ending the derogation might encourage the use of petrol engines in private pleasure boats

A.1 It has been suggested that, if the derogation were to end, some boat owners would convert or replace their engines to run on petrol, and that, as petrol is a much more volatile fuel, the risk of fire and explosion would be much greater.

A.2 On balance, we do not believe this would be a significant risk, since the cost of replacing or converting an engine would be substantial and would be greater than any saving possible from switching fuels. In addition, while diesel is more expensive on UK forecourts than petrol, diesel engines give greater fuel economy, so it seems unlikely that there would be any real benefit in such a change. However, there might be a move towards petrol engines in new craft, especially as new petrol engines are typically 40% cheaper than comparable diesel engines.

A.3 Should the safety of petrol engines become an issue that needs to be addressed it might be more appropriate to deal with it through regulation rather than through a tax incentive to encourage the use of diesel.

ULSD may have detrimental effects on some boat engines

A.4 Some boat owners have argued that, since ULSD has less lubricity than red diesel, it can affect engine performance and make them more likely to break down. This could have safety implications given that it could lead to boats being left powerless in the sea. In particular, we understand that as conventional diesel has less of the “aromatic” compounds that are found in red diesel, seals in the engine pump are more prone to shrinkage and wear, thus leading to fuel leakage (an unwelcome development if this increases river pollution) and loss of engine pressure.

A.5 We realise, however, that boat owners will have to tackle this issue in the longer term anyway since the EU Directive on sulphur levels in liquid fuels will lead to red diesel sulphur content being brought down to the same level as that for ULSD.

A.6 Under the Renewable Transport Fuels Obligation, all ULSD may in future contain at least 5% biodiesel. This will make the fuel more hygroscopic than red diesel, as biodiesel can absorb water in a concentration of up to 1,000 parts per million during storage. Once the solubility limit is exceeded, water separates inside the storage tank and collects at the bottom, causing problems that could lead to engines breaking down and corrosion of the fuel tanks.

Some boats could be stranded as a result of reduced availability of fuels

A.7 It is possible that this could happen given that ending the derogation would be likely to reduce the number of fuel suppliers in the UK. We do not believe that this would be a significantly greater problem than it is now. It would be for boat owners to take adequate precautions to ensure that they had sufficient fuel on board to cover their journey. However, smaller vessels (particularly motor vessels) might be unable to carry sufficient quantities in spare containers and the owners of such craft might have no option but to avoid the more remote and rural areas of the UK.

Fitting double tanks on boats may cause safety problems

A.8 If the derogation ended, boat owners might well fit additional tanks to their boats in order to continue to use rebated oils for heating, lighting, and cooking, although it might be difficult to ensure that boats refitted in such a way conformed with the Boat Safety Scheme requirements, particularly if the new tanks limited the space for movement on board.

ENVIRONMENTAL EFFECTS OF THE DEROGATION ENDING

A.9 Ending the derogation would be likely to lead to little or no savings of fuel. Although UK consumption of diesel by pleasure boats would be reduced, much of that reduction could be offset by consumption of fuel bought in other Member States by boats relocated there or through cross border shopping for fuels which could actually lead to higher consumption. In addition, having potentially fewer refuelling sites available might mean that more boats carried fuller tanks of fuel, making them heavier and therefore increasing their consumption.

A.10 In addition, if boat owners had to buy road diesel at marinas or elsewhere, it is likely that some of them would buy red diesel in 25 litre containers and fill up their tanks from these containers. Red diesel can be bought at some garages in rural and other areas where there is demand for its use in off-road machinery and vehicles. There would be an increased risk of spillages if fuel were decanted from these containers into boats' fuels tanks. This risk would also arise if marinas ceased stocking fuel because of the prohibitive costs of road diesel, so that boat owners were forced to buy fuel in containers and decant it.

NUMBERS OF LEISURE BOATS IN THE UK 2003

Table 21A.1 UK Leisure Boat Ownership 2003

Boat Length	Sail	Motor / Other	Personal Watercraft
2.5 – 7.5 metres	74,950	288,731	
7.5 – 12 metres	26,982	41,687	
12 – 24 metres	4,925	1,298	
24+ metres	15	21	
Total	106,872	331,737	12,094

A.11 Boat Ownership – the number of boats owned by citizens at home is 451,000 as shown above. A further 90,000 owned by citizens abroad.*

Table 21A.2 Leisure Boats based in the UK 2003

Boat Length	Sail	Motor / Other
2.5 – 7.5 metres	79,692	303,622
7.5 – 12 metres	28,689	44,026
12 – 24 metres	5,500	1,4256
24+ metres	17	27
Total	113,898	349,097

A.12 The figures for boats based in the UK include those owned or hired by residents of other, European and non-European countries.*

* Data are taken from the BMF, European Overview 2004

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