

Partial Regulatory Impact Assessment

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 (also known as “red diesel”). Entitlement to use of rebated gas oil on public roads would 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 would 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

Duty on oil raises funds for many types of Government expenditure, including the upkeep of the road network. Where vehicles are not used on public roads or make only incidental use of public roads, paying the full road fuel rate of duty can impose a disproportionate burden. For this reason the use of rebated gas oil is permitted in excepted vehicles as defined by Schedule 1 of the Hydrocarbon Oil Duties Act, 1979 (HODA). Entitlement to use rebated gas oil in excepted vehicles 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 while others do not. The ambiguity surrounding qualifying vehicles has made it possible for vehicle owners to misinterpret the rules, innocently in many cases, in others deliberately to gain advantage. Enforcement agencies face the same problems interpreting the schedule, resulting in a decreased risk of enforcement action. The result is a climate in which businesses can find themselves coming under pressure to disregard the law in order to compete with others doing the same.

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 distortions to 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 being pulled over by enforcement agencies.

Road fuel fraud is estimated to have cost the taxpayer around £600 million in 2004. The proportion of this fraud 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 those 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.

The schedule requires reform based on a consistent approach that reduces the scope for ambiguity. As part of this process of reform, and in the light of the development of new or 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?

3. 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 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 fits with the Government's Farm Regulation and Charging Strategy, which heralds a partnership approach to regulation between Government and the farming industry.

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 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. 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 have also been considered. 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.

Options

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

Accompanying this partial Regulatory Impact Assessment is a draft Treasury Order setting out the proposed changes to the excepted vehicles schedule. These 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 rebated gas oil only if such a declaration has been made. Unlicensed vehicles that do not require a SORN will continue to be able to use rebated gas oil 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 on public roads solely 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 vehicles constructed or permanently adapted, and used, solely for purposes relating to agriculture, horticulture or forestry, that are used on public roads only for travelling between jobs, and do not carry 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, pea viners and seed and feed processing machines.

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

This 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 and boom mounted mobile pump concrete pumps, 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.

- **Road surfacing vehicles – new category**

A new excepted vehicle category will be introduced to capture certain vehicles used in road surfacing. This category will be limited to purpose-built heavy plant, such as asphalt pavers and chipping machines, and to vehicles adapted as tar sprayers.

Costs and benefits

Sectors and groups affected

Amending the existing tractor and agricultural engine categories and introducing a new category for agricultural material handlers 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 to prevent opening of 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, and construction and utilities sectors. The mobile crane category would continue to include boom mounted mobile concrete pumps and truck mounted access platforms,

but would be restricted to vehicles with a revenue weight exceeding 3500 kilogrammes, and the types of equipment that can be carried by these vehicles would be clarified. The effect would be to remove around 1300 truck mounted access 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 a more limited road surfacing vehicle category 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 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 that would reflect changes in technology and commercial practice. The intention is to set revised definitions that are flexible enough to accommodate technological innovation and facilitate industry take-up of such technology. 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 that would 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. 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. Such adaptations can be temporary or relatively superficial, and in some cases the vehicles, even if used exclusively for road construction, continue to be suitable for other work. Much enforcement agency time is spent investigating possible abuses, with corresponding roadside delays for vehicle operators. 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. Furthermore, 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 where air quality is a greater concern. Proposed changes to the schedule would reduce the number of vehicles using rebated gas oil in urban 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 £15 million. 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. Figures demonstrating progress against the Oils Strategy targets up to 2005 will be available at the Pre-Budget Report in the autumn.

Costs

Option 1: Do nothing.

The identified problems with the current schedule would continue.

Option 2: To amend or delete categories.

Under this option the costs would be different for different sectors:

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** it 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 impact on progress made 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. One county council has been estimated that, if no use of rebated gas oil were to be allowed, the area of road surface dressed could be decreased by around 1-1.5%. However road rollers and front end loaders are unaffected by changes to the schedule, and following representations, chipping machines and tar sprayers will also continue to be able to use rebated gas oil under the new road surfacing category, since it is accepted that these make only incidental use of public roads and do not represent an enforcement problem. Of vehicles used in road surface dressing only tailboard chippers and roadsweepers will lose the right to use rebated gas oil. HMRC would welcome further information on the impacts on this sector in the light of these modified proposals.

In the **road safety marking sector** the additional cost of paying the full road fuel rate has been estimated by the industry as costing the industry approximately £5 million, which would equate to a total fuel consumption in the sector of around 10 million litres. Based on both large and small companies undertaking both private and public works overheads would increase by 17.5%, not including any increased administration or related costs as these are deemed to be marginal. This would lead to a likely price rise requirement of 17.5%, merely to maintain margins. The industry are concerned that where this cost would not be recoverable from their public sector clients that this could lead to business closures. They are also concerned that where costs could be passed on, pressure on local authority budgets would result in a reduction in work on the road-marking infrastructure. This could make achievement of Government targets in casualty reduction and congestion less likely. In the case of larger companies working on larger government funded contracts the impact could rise to 19 - 20% as a result of the level of competition and type of contract, the increased costs (where they can be transferred) being felt by government departments and agencies. HMRC would welcome further information quantifying these impacts.

Impacts in other sectors of the road construction industry have not been quantified and HMRC would welcome any further information.

In due course HMRC will also undertake a review of the figures in this RIA in Standard Cost Methodology terms.

6. Small Firms Impact Test

Excepted vehicles are used by businesses of all sizes. Small firms have responded to the consultation both welcoming and opposing changes. 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. HMRC would welcome comments on this assessment.

7. Competition assessment

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. Any changes to

the schedule will need to be assessed to ensure that they do not result in new distortions, and the Government would welcome further information on how proposed changes would impact on competition.

8. 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.