

Regulatory Impact Statement: Customs and Excise Act Review: Regulations: Removal of motor spirits from Customs-controlled areas and blending

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the New Zealand Customs Service (Customs).

It provides an analysis of options to prescribe matters under Schedule 3 (clause 10) of the Customs and Excise Bill concerning the removal of motor spirits from a Customs-controlled area, and blending at tank farms.

There are no major gaps, constraints, or uncertainties concerning the analysis.

Signed by Anna Cook on 31 July 2017

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31 July 2017

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Executive summary

- 1 In November 2015 EGI [EGI-15-MIN-0129] agreed excise will continue to be collected at the main excise points (when fuel leaves the Marsden Point refinery, and when it is imported into the tank farms) and a new collection mechanism be created at the gantry of tank farms.
- 2 Clause 10 of Schedule 3 of the Customs and Excise Bill provides for regulations to be made to clarify the operation of the excise point at tank farm gantries. It also provides for regulation to ensure that the excise point at the Refinery is maintained.
- 3 The maintenance of the excise point when fuel is imported into the tank farms has already been addressed via an Order in Council effective from 1 February 2017.
- 4 It is proposed that regulation be made to restrict the chief executive's discretion to allow dutiable motor spirits to leave a Customs controlled area duty unpaid. This will provide additional assurance that the major excise point for domestically manufactured motor spirits at the Marsden Point refinery will be maintained. Such restriction, except in emergency situations, will reduce the risk of legal challenge where the discretion is not exercised in an applicant's favour.
- 5 It is also proposed that regulation be made specifying a formula for calculating the additional volumes of motor spirits produced as a result of blending operations at tank farms. This will provide the necessary clarity for both industry and Customs in relation to this new collection mechanism established in the Bill.
- 6 Two other provisions under clause 10 permit regulations to be made: prescribing any further conditions necessary before excise can be assessed on incremental volume increases, and prescribing when duty credits may be claimed in respect of the original dutiable motor spirits. Customs and industry agree that neither of these areas require regulations to be made at this time.
- 7 The industry participants directly affected have been consulted and support the recommended options in this Regulatory Impact Statement.

Status quo and problem definition

Current collection of excise on motor spirits

- 8 Excise is levied on motor spirits manufactured in New Zealand, and excise-equivalent duty is levied on imported motor spirits. Excise is paid on motor spirits when it leaves the Marsden Point refinery, and excise-equivalent duty is paid when motor spirit is imported into tank farms (the main existing excise points). Excise is also levied and paid on additional volumes of motor spirits produced by blending at the tank farms. The Bill creates a new excise collection mechanism at the tank farms.
- 9 Under the Customs and Excise Act 1996, and in the Bill, the chief executive has discretion to allow dutiable goods including motor spirits to leave a manufacturing area duty unpaid (for example, when it is for further manufacture). Under clause 10(1) of Schedule 3 of the Bill, regulations may provide that the chief executive must not exercise that discretion to allow dutiable motor spirits to leave a manufacturing area duty unpaid (either when goods are transferred to another Customs-controlled area (CCA) or removed temporarily).
- 10 About 99.7% of excise duty on motor spirits is collected at the two main excise points. The balance of 0.3% relates to the incremental volume of motor spirits produced by blending at tank farms. Blending arises when interface/slops (mixture of fuels resulting from terminal operations) and company-specific additives are blended with original RON 91 motor spirits. The excise duty on such blending is currently around \$6 million per annum.

Problem definition

- 11 To ensure that the excise point at the Refinery is protected in respect of domestically refined fuel, it is necessary to decide whether regulations should be made to restrict the chief executive's discretion, and if so, to what extent. Without such restriction, there would be a risk of legal challenge where the discretion is not exercised in an applicant's favour.
- 12 It is also necessary to consider how best to provide a clear and authoritative basis to ensure that excise on motor spirits is calculated correctly in respect of the small additional volumes of motor spirit produced at tank farms by blending (a new excise collection mechanism is introduced in the Bill).
- 13 Two other provisions under clause 10 permit regulations to be made: prescribing any further conditions necessary before excise can be assessed on incremental volume increases, and prescribing when duty credits may be claimed in respect of the original dutiable motor spirits. Customs and industry agree that neither of these areas require regulations to be made at this time.

Objectives

- 14 The overriding objective is to collect all due excise on motor spirit in an accurate, timely and low-cost manner.
- 15 The criteria used to evaluate the options are:
 - accurate and timely excise collection
 - low compliance and administration costs.

Options and impact analysis

- 16 The implications of the objectives are that Customs will need to:
- continue to collect excise on motor spirit manufactured in the Refinery or other manufacturing areas, and not allow it to leave a CCA without excise being paid
 - collect excise on the incremental volume of motor spirits produced in tank farms.
- 17 There are no non-regulatory options. Motor spirits excise is a duty and provisions for its imposition and collection are established in legislation.

The movement of motor spirits between Customs-controlled areas

- 18 Under clause 10(1) of Schedule 3 of the Bill, regulations may provide that the chief executive must not exercise the chief executive's power to allow dutiable motor spirits to leave a manufacturing area duty unpaid (either when transferred to another CCA or temporarily).
- 19 Such regulations may relate to a specified CCA or a specified class of CCA, and apply in all circumstances or in prescribed circumstances only.

Comment

- 20 The key question is whether the chief executive's discretion should be restricted, and if so, how? For example: should the restriction only relate to the Marsden Point refinery, or any CCA where motor spirit is manufactured or refined in New Zealand? Should it apply in all circumstances, or only in circumstances set out in regulation? What might those circumstances be?
- 21 The policy intent is clear that, for this significant excise point, no deferral in collection should be permitted, or the risk of any deferral should be minimised. Excise on motor spirits leaving the refinery is the largest single collection point for excise.
- 22 To ensure clarity in relation to fuel excise collection points, the Bill provides both an explicit recognition that additional volumes created by blending are to be treated differently, and an explicit power to restrict when the discretion may be used.
- 23 Accordingly, regulating to restrict the chief executive's discretion under clause 10(1) of Schedule 3 of the Bill is appropriate.

Evaluation of options

Option	Description	Accurate, timely excise collection	Low compliance and administrative costs
Option A	Do not restrict CE's discretion	✗	✗
Option B	Restrict in relation to motor spirit refined at Marsden Point	✓	✓
Option C	Restrict in respect of motor spirit refined anywhere in New Zealand	✓	✓
Option D (preferred)	Restrict in respect of motor spirit manufactured in any CCA	✓	✓

Key: ✓ option supports this objective ✗ option does not support this objective

- 24 It is considered that the restriction should be prescribed in terms of motor spirit manufactured in any CCA (option D in the table above). There is very little difference between options B, C and D. The formulation in Option D is preferred because it is the most comprehensive and future-proofed. Industry supports this option.

Emergency situations

- 25 During consultation, the fuel companies indicated that the ability to exercise discretion should continue to be available as an exception for emergency situations. An example of such a situation is where, as a result of fire or damage, motor spirit needs to be removed from a CCA as a matter of priority.
- 26 There is no impediment to the physical removal of motor spirits in response to an emergency. Without a discretion being exercised by the chief executive to permit such removal, however, such removal would trigger an excise liability because it would constitute removal for home consumption.
- 27 Emergency removal is not a policy concern. The policy concern is to ensure that excise payment is not unnecessarily delayed. Currently such situations are covered by the ability of the chief executive, under clause 214(1), to allow the temporary removal of goods from a CCA without payment of duty for a time considered appropriate. Such temporary removal can also be permitted subject to appropriate security and any appropriate conditions under clause 219. This provides sufficient safeguards for temporary removal in an emergency situation.
- 28 On balance, it is considered that when the chief executive's power is restricted under clause 10(1) of Schedule 3, a discretionary power for emergency situations should remain by allowing clause 214(1) to operate in the circumstance of an emergency situation, and not otherwise.

Conclusion

- 29 The chief executive's discretion should be restricted. Restricting the discretion provides clarity that excise is paid when motor spirit leaves any CCA. This restriction should be subject to an exception for emergency situations under clause 214(1).

New dutiable motor spirits attributable to other substances

- 30 Under clause 10(6), regulations may, for the purposes of sub-clause (4), prescribe how the proportion of the new dutiable motor spirits that is attributable to the other substances is to be determined.

Comment

- 31 The key question is whether regulation is needed to prescribe how the excise is levied on the increment? For example, a formula or process might be used. If so, what should the method be?
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- 32 The following options are considered:
- Option A: No formula
 - Option B: A flow and stock formula (described below)
 - Option C: A formula which directly measures the source of the increment being those "other substances" which have not already paid the full excise.

Evaluation of options

- 33 In order to provide the necessary level of clarity for both industry and Customs, it is considered necessary to prescribe a method for the calculation of the incremental volumes of fuel produced at tank farms. This need for clarity rules out Option A.
- 34 Option B provides for methods like those described in the Procedure Statements (which, for each tank farm CCA, set out the terms and conditions of the licence). A stock and flow formula would be specified as follows:

$$(\text{volume out} + \text{closing stock}) - (\text{volume in} + \text{opening stock}) \\ = \text{dutiable incremental volume of motor spirits}$$

where -

- volume in: equals the volume of the original dutiable motor spirits, and may include quantities of RON 91/95/98 motor spirits included in any waste motor spirits, received into the CCA during the measurement period
 - opening stock: equals the volume of dutiable motor spirits held at the CCA at the start of the measurement period (for the avoidance of doubt, this will equal the closing stock of the prior measurement period)
 - volume out: equals the volume of the new dutiable motor spirits removed from the CCA during the measurement period
 - closing stock: equals the volume of dutiable motor spirits held at the CCA at the end of the measurement period.
- 35 Industry has indicated that this approach is well understood, and operates satisfactorily alongside measurements which the companies are required to perform to meet their own audit and management requirements. Industry prefers this option. Customs considers that Option B is a practical method which results in the accurate calculation of the excise on incremental volumes.
- 36 Option C would involve the measurement of only the very small quantities which generate the incremental volumes. This would avoid the need to measure the 99.7% of fuel which has already been subject to excise. Industry has indicated, however, that there is an imprecise relationship between the incremental volume of motor spirit and the quantities of the other substances which generate the increment, and that it is more accurate to derive the incremental volumes by means of the formula in Option B.
- 37 The above discussion of the options results in the following evaluation:

Option	Description	Accurate and timely excise collection	Low compliance and administrative costs
Option A	No formula	✗	✗
Option B (preferred)	A stock and flow formula (such a formula in Procedure Statements)	✓	✓
Option C	Measure increment directly	✗	✗

Key: ✓ option supports this objective ✗ option does not support this objective

Conclusion

- 38 The preferred approach is option B involving a flow and stock formula, as highlighted above.

Impacts of proposals

- 39 The proposed regulations serve:
- to clarify and ensure that excise will continue to be collected when motor spirit leaves the refinery
 - to provide a transparent formula for the calculation of excise on motor spirit from blending at the tank farms.
- 40 Relative to the status quo, the regulatory proposals in this RIS are expected to have no or negligible impact on industry participants.

Consultation

Industry consultation

- 41 Customs has undertaken consultation with the fuel companies throughout the Customs and Excise Act review process over the last two years. A workshop was conducted with industry stakeholders on 10 July 2017 to discuss development of these regulations. Participants included Z Energy, BP, Mobil and Gull New Zealand Ltd/ Terminals (N.Z.) Ltd. Wiri Oil Services Ltd (WOSL), the tank farm supplying the Auckland region (jointly owned by Z, BP and Mobil) and Refining NZ, have been kept informed.
- 42 Industry agrees with the recommended options in this RIS, and supports additional guidance on terms used in the formula which Customs will provide as part of implementation.

Departmental consultation

- 43 Customs has consulted with the Ministry of Transport, The Treasury, MBIE, and the Inland Revenue Department. No issues have been raised. The Department of the Prime Minister and Cabinet has been informed.

Conclusions and recommendations

- 44 Restricting the chief executive's discretion to allow motor spirits to leave the Refinery duty unpaid will strengthen excise collection at this major excise point. It reduces the risk of legal challenge where the discretion is not exercised in an applicant's favour. It would be appropriate to allow an exception for emergency situations.
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- 45 It is necessary to regulate to provide an authoritative formula for the calculation of excise on motor spirit from blending at the tank farms. This will provide the necessary clarity for industry and Customs. The recommended formula is agreed by industry and Customs.
- 46 It is recommended that:
- the chief executive's discretion to allow motor spirit to leave any CCA duty unpaid be restricted subject to an exception for emergency situations

- a stock and flow formula be specified for the calculation of excise on additional volumes of motor spirit produced by blending at tank as follows: (Volume out + closing stock) – (volume in + opening stock) = dutiable incremental volume of motor spirits.

Implementation plan

- 47 Customs has established and resourced a dedicated implementation team to prepare for and put into effect the necessary arrangements to operationalise the proposed regulations. This process includes workshops with both Customs and industry stakeholders.
- 48 Customs will provide information and guidance to support the introduction of the proposed regulations. Customs will also aim to ensure that its guidance and processes ensure, as appropriate, a nationally consistent application of the regulations. Customs will involve industry participants in the development of the guidance.
- 49 Industry raised some issues with the Customs excise entry form they are required to use for entering excise at the tank farms. Customs will work with industry to develop guidance on what is required on the excise entry form, and whether any improvements can be made to the form.
- 50 Industry also indicated that there is a need for further clarity in relation to the precise application/meaning of the terms in the formula. Clarity is important for both industry and Customs. Industry also indicated the need for a level playing field and the need for national consistency across Customs. Customs will develop guidance to ensure there is clarity for all parties.

Monitoring, evaluation and review

- 51 Customs is responsible for the overall process governing the collection of excise and excise-equivalent duty on motor spirits. This involves overseeing the excise entries by companies, collecting the excise, and monitoring and auditing entries and payments.
- 52 Customs will ensure there is opportunity for any issues to be raised, discussed, and resolved concerning any aspect of the process. There is a strong mutual interest in ensuring the process is clear and works effectively.