

**EXPLANATORY MEMORANDUM TO**  
**THE HYDROCARBON OIL DUTIES (RELIEFS FOR ELECTRICITY**  
**GENERATION) REGULATIONS 2005**

**2005 No. 3320**

1. This explanatory memorandum has been prepared by the Commissioners for Her Majesty's Revenue and Customs and is laid before Parliament by Command of Her Majesty.

**2. Description**

2.1 These Regulations, which come into force on 1 January 2006, introduce a relief from excise duty for rebated oils used to generate electricity in a generating station or combined heat and power station. The relief takes the form of a repayment payable, subject to certain conditions, on the written application of a qualified claimant.

**3. Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 None.

**4. Legislative Background**

4.1 Section 6 of the Hydrocarbon Oil Duties Act 1979<sup>1</sup> ("the Oil Act") provides for a duty of excise to be charged on hydrocarbon oil<sup>2</sup> imported into the United Kingdom or produced in the United Kingdom and delivered to home use from certain specified premises. The rates of duty for different types of hydrocarbon oil are set out in section 6(1A) of the Act but these are subject to various rebates and reliefs. In particular, where heavy oil is delivered for home use a rebate is allowed under section 11 of the Act<sup>3</sup>. The amount of the rebate will depend on the nature of the oil.

4.2. Certain electricity generators use rebated heavy oil, in particular gas oil and fuel oil<sup>4</sup>, as part of the generating process. Climate change levy (CCL) is chargeable, subject to various exemptions, on the supply of electricity in certain specified circumstances<sup>5</sup>. CCL is also chargeable on various taxable commodities that can be

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<sup>1</sup> c. 5. Section 6(1) was amended by section 4(2) of the Finance Act 1982 (c. 39). Section 6(1) was amended and section 6(1A) inserted by section 7 of the Finance Act 1997 (c. 16). Section 6(1A) was amended by sections 4(1) and 5(3) of the Finance Act 2000 (c. 17), section 1(1) of the Finance Act 2001 (c. 9), section 4(1) of the Finance Act 2003 (c. 14), sections 5(1) and 7(5) of the Finance Act 2004 (c. 12) and sections 4(2) and 5(2) of the Finance Act 2005 (c. 7).

<sup>2</sup> A term defined in section 1 of the Oil Act. Section 1 was amended by section 7 of the Finance Act 1997, section 8 of the Finance Act 1998 and section 7 of the Finance Act 2004.

<sup>3</sup> Section 11 was amended by section 2(2) of the Finance Act 1986 (c. 41), section 5(2) of the Finance Act 1996 (c. 8), section 7(5) of the Finance Act 1997 (c. 16), section 2(3) of the Finance Act 1999 (c. 16), section 4(2) of the Finance Act 2000 (c. 17), section 5(1) of the Finance Act 2003 (c. 14), section 5(3) of the Finance Act 2004 (c.12) and sections 4(7) and 5(6) of the Finance Act 2005 (c. 7).

<sup>4</sup> Terms defined by sections 1(5) and 11(3) of the Oil Act respectively. Section 1(5) was inserted by section 7(1) of the Finance Act 1997 (c. 16); section 11(3) was inserted by section 10(1) of the Finance Act 2000 (c. 17)

<sup>5</sup> See section 30 of, and Schedule 6 to, the Finance Act 2000 (c. 17) and regulations made thereunder. In particular see paragraphs 5 and 8 to 13 of Schedule 6.

used in the production of electricity, for example coal and gas<sup>6</sup>. In order to avoid double taxation those commodities are, broadly speaking, exempt from the levy where they are to be used to produce electricity<sup>7</sup>. This means that the levy is paid on the outputs (the electricity) and not on any inputs (such as coal). Electricity generated from oil, however, is subject to double taxation – on the input fuel (under hydrocarbon oil duty) and on the electricity output (under CCL).

4.3 Council Directive 2003/96/EC<sup>8</sup> (of 27th October 2003 restructuring the Community framework for the taxation of energy products and electricity, commonly known as “the Energy Products Directive” or “EPD”) applies in relation to excise duties on mineral oils and other products that might be substitutes for them. Article 14(1)(a) of the EPD provides that energy products (including hydrocarbon oil) used to produce electricity or to maintain the ability to produce electricity should be exempt from taxation. However, Member States are permitted to subject energy products used in this way to taxation for reasons of environmental policy. Article 15(1)(c) of the Directive provides that Member States may apply total or partial reductions in the level of taxation to energy products and electricity used for combined heat and power stations.

4.4. Most of the provisions in the EPD were already implemented in UK law by the Oil Act (and legislation made under the Oil Act) and by the legislation that provides for CCL, although certain changes from previous directives were given effect by the Finance Act 2004 and secondary legislation made in that year. A transposition note for the EPD can be found in the annex to this memorandum.

4.5 The EPD was considered by the House of Commons European Scrutiny Committee on 27 November 2002<sup>9</sup> and cleared by sub-Committee A of the House of Lords Select Committee on the European Union by letter dated 5 December 2002 to Dawn Primarolo, Paymaster General, HM Treasury<sup>10</sup>.

4.6 At the time the EPD came into force the Commissioners took the view that the treatment of hydrocarbon oil used in the production of electricity was justified for reasons of environmental policy. Following concerns expressed by the European Commission and representations from the Association of Electricity Producers (AEP), the Commissioners now consider that their earlier arguments are outweighed by the need to avoid double taxation wherever possible. They also wish to ensure compliance with Article 14(1)(a) of the EPD.

4.7 This instrument introduces a relief from excise duty for rebated heavy oils used to generate electricity in a generating station or combined heat and power station. Relief is allowed, subject to conditions, on the written application of a qualified claimant (as defined in regulation 2).

4.8 Relief is not allowed where the oil is used by an autogenerator or an exempt unlicensed electricity supplier. Under the CCL legislation autogenerators and exempt unlicensed suppliers, who supply electricity to themselves, local users or associated

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<sup>6</sup> See paragraphs 6 and 7 of Schedule 6 to the Finance Act 2000.

<sup>7</sup> See, in particular, paragraph 14 of Schedule 6 to the Finance Act 2000.

<sup>8</sup> OJ No L 283, 31.10.2003, p 51

<sup>9</sup> 2nd Report of Session 2002-03, HC 63-ii.

<sup>10</sup> Progress of Scrutiny, First Report for Session 2002-03, 9 December 2002, ISBN 010 490192 6.

companies are exempt from CCL on the electricity that they produce. Instead, CCL is charged on their inputs. This implements the third indent of Article 21(5) of the EPD which provides that Member States may exempt small producers of electricity provided they tax the energy products used for the production of that electricity.

4.9 Autogenerators and exempt unlicensed suppliers may supply some of the electricity that they produce to an electricity utility, or to a person treated as such for CCL purposes. If they do so, to avoid double taxation, CCL is not charged on the input fuel used to produce that electricity. Relief under this instrument is therefore allowed in the same situation.

4.10 Combined Heat and Power (CHP) stations are a particular type of energy efficient power station. CHP stations that participate in the CHP Quality Assurance (CHPQA) programme administered on behalf of the Department for Environment, Food and Rural Affairs can either be fully exempt or partially exempt from CCL, subject to meeting certain criteria in relation to their energy efficiency and environmental performance<sup>11</sup>.

4.11 Where the criteria are not fully met relief from CCL is scaled back. This is calculated by applying the “relevant fraction”, the ratio between a station’s efficiency percentage and the relevant threshold efficiency percentage, to supplies made to the station<sup>12</sup>. Such stations are entitled to similar relief under this instrument.

## **5. Extent**

5.1 This instrument applies to all of the United Kingdom.

## **6. European Convention on Human Rights**

As the instrument is subject to the negative resolution procedure and does not amend primary legislation, no statement is required.

## **7. Policy background**

7.1 Currently, electricity generators using rebated heavy oil, and in particular gas oil and fuel oil, as part of their generating process pay hydrocarbon oil duty. As CCL is chargeable on supplies of electricity made by licensed suppliers, most generators using coal or natural gas do not have to pay any form of tax on their input fuel. However, similar classes of generators using oil pay hydrocarbon oil duty. Therefore, electricity generated from oil may be subject to double taxation – on their input fuel (under hydrocarbon oil duty) and on the electricity output (under CCL). The European Commission has expressed the view that by subjecting electricity generated from oil to double taxation in this way, the UK is in breach of Article 14(1)(a) of the EPD. The aim of relieving from excise duty rebated heavy oils used for electricity generation is therefore to avoid double taxation, wherever possible, and ensure consistency of treatment with other energy products used for the same purpose.

7.2 The policy has been developed taking into account views informally gathered from the AEP and Combined Heat and Power Association (CHPA). The AEP, CHPA and

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<sup>11</sup> See in particular paragraphs 15 and 16 of Schedule 6 to the Finance Act 2000 (c. 17) and article 15(1)(d) of the EPD.

<sup>12</sup> See paragraph 15(2) of Schedule 6 to the Finance Act 2000 (c. 17).

other stakeholders have been consulted on a draft of these Regulations and on the regulatory impact assessment (RIA). There were 13 responses to the consultation. Most of the respondents support introduction of the relief, and where specific comments were made, these have been taken on board wherever possible. Two responses expressed concern about the potential impact on the demand for oils and other fuel substitutes used for electricity generation which are not currently subject to hydrocarbon oil duty, and which are claimed to be more environmentally friendly. Whilst demand for such fuels in the electricity market may be affected, choice of fuels is a matter for generators, who must comply with environmental legislation. Other specific measures have been put in place to support alternative fuels where appropriate.

## **8. Impact**

8.1 A Regulatory Impact Assessment is attached to this memorandum.

8.2 The impact on the public sector is negligible.

## **9. Contact**

Ann Little at HM Revenue and Customs Tel: 020 7147 0383 or e-mail: [ann.little@hmrc.gsi.gov.uk](mailto:ann.little@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.