



Petroleum or Engine Fuel Monitoring Levy

Consultation on scope and calculation of levy

Making a submission

You are invited to make a written submission on the issues raised in this paper. Submissions should be received at the Ministry of Business, Innovation and Employment (**MBIE**) by 5pm on 25 August 2015.

Your submission may respond to any or all of the issues outlined, depending on your interest. In addition, you are welcome to provide other information that you think might be relevant to this consultation. If possible any views outlined in the submission should be supported by evidence, such as references to independent research, facts and figures, or examples. Please also include your name, or the name of your organisation, and contact details.

Submissions may be made electronically (preferred) or by post. Electronic submissions should be in Adobe Acrobat or Microsoft Word or compatible format and sent as an attachment to: energymarkets@mbie.govt.nz.

Postal submissions should be sent to:
Energy Markets
Building, Resources and Markets Group
Ministry of Business, Innovation and Employment
P O Box 3705
Wellington.

Use of information

The information provided in submissions will be used to inform our analysis and the advice given to Ministers. We may contact submitters directly if we require clarification of any matters in the submission.

We intend to post written submissions received on the issues paper on MBIE's website at www.mbie.govt.nz. Therefore, please read the advice below regarding confidential or private information. MBIE reserves the right to remove any material from submissions that may be defamatory.

Confidential Information

If your submission contains any confidential information, please indicate this on the front of the submission. In addition, the confidential information should be clearly marked within the text, for example, by including the confidential information in square brackets or as a separate appendix.

If you wish to provide a submission with confidential information, we prefer that you also provide a separate public version of the submission which excludes the confidential information. If provided, the public version will be posted on MBIE's website.

In any case, if MBIE receives a request under the Official Information Act 1982 for a copy of submissions, MBIE will need to make its own assessment of whether the information should be released, including whether it is in the public interest to release the information received. In this event, MBIE will endeavour to consult with submitters that have provided confidential information prior to making its decision on the request.

Personal Information

The Privacy Act 1993 establishes certain principles with respect to the collection, use and disclosure of information about individuals by various agencies, including MBIE. Any personal information you supply to MBIE in the course of making a submission will be used by MBIE only in conjunction with providing its advice on a public interest test. Please clearly indicate in your submission if you do not wish your name or contact details to be posted on MBIE's website or included in any summary of submissions that MBIE may publish.

Introduction

1. This discussion paper considers which fuels should be covered by the Petroleum or Engine Fuels Monitoring Levy (**PEFML**), and how the levy should be calculated.

Background

2. New Zealand has a treaty obligation under the Agreement on an International Energy Program to hold oil stocks equivalent to at least 90 days of net oil imports. The government has historically met its obligation through augmenting local stocks and exports by entering into ticket contracts with oil companies or traders in other International Energy Agency (**IEA**) member countries. Tickets are an option, in return for an annual fee, to purchase specified quantities of stock at market prices in the event of an IEA-declared oil supply emergency.
3. Stocks held as tickets in other countries are counted by the IEA as reserves for the ticket-owning country, not the country in which the stock is located.
4. The obligation to hold 90 days of net imports is New Zealand's contribution to global oil security and is part of a system managed by the IEA to mitigate the impact of oil supply shocks by providing a buffer of emergency oil stocks that can be collectively released onto the market. This obligation has previously been funded through general taxation, although going forward it will be funded by increasing the PEFML. The cost of this obligation is also increasing - the government increased the total appropriation for ticket contracts over 2013/14 – 2015/16 from \$9 million to \$20.540 million.
5. The Energy (Fuels, Levies, and References) Amendment Act 2015 (the **Amendment Act**) was passed in February and amends the purpose for which the PEFML can be collected to include “compliance by the Crown with New Zealand’s obligation under Article 2 of the International Energy Agreement, to maintain the emergency reserve commitment set out in that Article”¹. The costs collected under the extended purpose are unable to exceed those set out in the Estimates of Appropriation. The Amendment Act also:
 - a. removes the maximum PEFML rate of 0.045 cents per litre of fuel (the current rate of collection); and
 - b. provides for the Minister of Energy and Resources to make regulations to set the PEFML rate and the fuels to which the PEFML applies.
6. The PEFML is currently collected on petrol, diesel, ethanol, and biodiesel. A full table of tariff items and excise items subject to the levy is included in Annex 1, and a breakdown of New Zealand’s oil product consumption is included in Annex 2. The expanded PEFML will continue to fund the existing purposes for which the levy is currently collected (including safety monitoring costs, acquisition of energy data and liaison with the IEA). The recovery for the IEA obligations will be in addition to these current costs.
7. The PEFML is collected by the New Zealand Customs Service (**Customs**).
8. Regulations need to be made to put the extension of the PEFML’s purpose into practice, to identify the fuels to which the levy applies, and set the levy calculation.

¹ Energy (Fuels, Levies and References) Act, article 14(2)(ba)

Issue

9. The Government has already decided to collect the costs of the IEA obligation from fuel consumers via the PEFML. This consultation paper considers:
 - a. whether there should be a change in the type of fuels that should be subject to the levy; and
 - b. how the levy should be calculated.

Selection criteria

10. We have taken into account the Treasury's "Guidelines for Setting Charges in the Public Sector", December 2002 and the Controller and Auditor-General's "Charging fees for public sector goods and services", June 2008 in formulating this discussion document. The following criteria are applied to assess the options:

- a. **Equity ("fairness or justice")**

One of the objectives when considering user charges or levies is dealing equitably with those who benefit from the service, and/or those whose actions give rise to it.

Beneficiaries of oil security should pay for that security proportionate to the benefit. Applying this principle suggests that it is more equitable to apportion the cost of the stockholding proportionally to the volume of fuel consumed. This is because the security benefit of an intervention to halt oil price spikes is higher for those with higher fuel consumption (i.e. fuel consumers are likely to benefit more from oil security the more fuel they consume).

- b. **Efficiency (exacerbator pays)**

The cost of meeting IEA stockholding obligations should be targeted at consumers of those fuels who:

- i. exacerbate the risk of an oil supply disruption through their collective reliance on imported oil supplies, and
 - ii. as a result, exacerbate the risk of non-compliance with our IEA treaty obligation by adding to the level of stock that New Zealand is required to hold.

- c. **Administrative simplicity**

The imposition, collection, and compliance with the levy should be low cost. It should be difficult for liable parties to avoid paying levies under any funding mechanism.

Fuels to levy

11. We have identified two options for considering the fuels that should be subject to the PEFML:
 - a. Petrol, diesel, ethanol and biodiesel (the 'status quo').
 - b. Petrol and diesel only.

12. In principle, the levy should apply to all fuels that are included in the calculation of New Zealand's 90-day net import position.² That is, petrol, diesel, jet fuel, fuel oil, ethanol for blending into petrol or diesel, and "other petroleum products" like LPG, bitumen and solvents. This would best satisfy the 'equity' and 'efficiency' criterion. However, a number of fuels cannot practicably be levied and are not currently covered by the PEFML:

- **International or domestic aviation fuel and fuel oil -**

New Zealand is a signatory to the Convention on International Civil Aviation, which exempts jet fuel for international travel from taxation. We are mindful of the Crown's obligations under this Convention.

Conceptually, the levy could still be collected on jet fuel for domestic travel. However, accurate reporting of domestic and international sales of jet fuel would raise practical difficulties and add significant compliance costs. Levying domestic jet fuel and fuel oil may not satisfy the 'administrative simplicity' criteria.

- **"Other petroleum products"** - It may be impractical and costly to administer a levy on these products given the small quantities involved and the involvement of various suppliers other than the main oil companies. A levy on "other petroleum products" may not satisfy the 'administrative simplicity' criteria.

13. These limitations also apply to an expanded PEFML, and effectively eliminate all fuels from its potential scope, except for petrol, diesel, ethanol, and biodiesel.

Option One: Petrol, diesel, ethanol and biodiesel

14. Under this option the expanded PEFML would mirror the status quo. That is, the expanded PEFML would apply to petrol, diesel, ethanol and biodiesel, but exclude aviation fuel (international and domestic), and "other petroleum products" for the reasons discussed above.

15. Inclusion of petrol and diesel in the expanded PEFML is undisputed as involvement in IEA activities is principally meant to help mitigate the risks of unpredictable oil markets. Currently ethanol and biodiesel (collectively referred to as biofuels) are also included in the PEFML.

Exacerbation of oil stock holding obligations

16. New Zealand's oil stock holding obligations are largely determined by the amount of all of our imported fuel.

17. The IEA formula for net imports does not distinguish between biofuel and mineral fuel. If all of New Zealand's fuel consumption was imported biofuel, we would still have an IEA obligation to hold oil stocks.

18. If an increase in demand were met by an increase in imported crude or imported biofuel, then New Zealand's net imports would rise. Demand for imported biofuel or mineral fuel

² The IEA defines the 90-day net import position as being daily net imports x 90. The IEA calculates the 90-day requirement for a given year by multiplying the average daily net imports of the previous year by 90. New Zealand's oil stock holding obligations are therefore determined by its amount of imported oil. In recent years New Zealand has met about half the requirement by stock held by commercial operators. The remainder of the requirement is made up by the Government entering into ticket contracts with overseas companies (oil companies and traders).

therefore exacerbates the need for oil stocks. In contrast, meeting an increase in demand by an increase in domestically produced biofuel or mineral fuel refined from domestically produced crude oil would have no effect on net imports and would therefore not exacerbate the need for oil stocks.

Beneficiaries of oil stock holding obligations

19. All fuel consumers, both mineral and biofuel (whether imported and domestic) will benefit from the release of oil stock in the event of an IEA declared emergency. This is because the price of biofuels is tightly coupled to oil prices.³ The suppression of oil prices from an IEA oil stock release would also suppress the price of biofuels, which would otherwise spike.

Low cost option

20. Maintaining the status quo and not changing the current scope of the PEFML is the most low cost of the two options. No additional costs will have to be incurred in levy collection beyond those involved in changing the levy rate, which is unavoidable.

Option Two: Petrol and diesel only

21. This option builds on the existing exclusions for aviation fuel, and “other petroleum products”, by also excluding biofuel from the expanded PEFML.

Exacerbation of oil stock holding obligations

22. Currently, around 80 per cent of the biofuel that New Zealand consumes is produced domestically. In 2013, 5.2 million litres were domestically produced and 1.3 million litres were imported. In contrast, almost all mineral fuels in New Zealand are imported or refined from imported feedstock. In 2013, only 3 per cent of domestically produced crude oil was refined in New Zealand.
23. Given that most biofuel is domestically produced while almost all mineral fuel is imported, it may be considered reasonable to exempt biofuels from the expanded levy because demand for those fuels only marginally exacerbates the need for oil stocks (relative to demand for mineral fuels).⁴ However, as discussed above, the close relationship between mineral and biofuel means that, in the event of a release of oil to stocks to mitigate a spike in oil prices, users of domestically provided biofuel would also benefit.

Levy only imported biofuels

24. We have not considered levying only imported biofuel and not domestically produced biofuel as we are mindful of our international obligations under the General Agreement on Tariffs and Trade (GATT). Option Two therefore proposes excluding all biofuels from the PEFML. It would also be impractical and costly to make a distinction between applying a levy to imported and not domestic biofuels at the pump, which may not meet the ‘administrative simplicity’ selection criteria.

³ Tightly coupled prices are expected for tradable goods that are close substitutes. This is the case in New Zealand, where most biofuels are blended with mineral fuels like petrol and diesel and are, therefore, close substitutes.

⁴ Note that if the amount of imported biofuels were to materially increase, then the weighting given to this ‘equity’ criterion would need to be revisited as New Zealand’s dependence on imported fuels would increase.

Impact on price of biofuel blends

25. In 2013, 6.5 million litres of biofuels were consumed, which made up around 0.1 per cent of fuel demand. In the same year 6.05 billion litres of petrol and diesel were consumed.
26. Excluding biofuels from the PEFML may send a signal to encourage the uptake of biofuels, which would also advance the long term energy goal of increased use of renewables.
27. However, the new levy is initially likely to be approximately an additional 0.18 cents per litre compared to the current 0.045 cents per litre (discussion on the levy calculation method is discussed in the Levy Rate section of this document). We consider the cost savings resulting from removing the levy from biofuels are so small as to be unlikely to effect biofuel uptake.

Administratively complex

28. It may be administratively complex and costly for Customs, which collects the levy to change the scope and exclude biofuels. There may also be increased compliance costs for manufacturers and importers of biofuel blends. This is due to the complex structures that will be required to separate out, and make levy returns on, the mineral fuel but not the biofuel portion of a fuel blend. This would not appear to satisfy the 'administrative simplicity' criterion.

Future proofing

29. If the market changes and New Zealand's fuel production and/or import type change, or for example the IEA obligation changes, then regulations are able to be amended to take these changes into account. This flexibility is the advantage of setting the levy rate by regulations rather than by statute.

Q1) Do you agree with Option One (petrol, diesel, ethanol and biodiesel), or Two (petrol and diesel only)? Why or why not?

Q2) Do you agree with the relevant costs and benefits identified under Options One or Two? Why or why not?

Levy rate

30. The PEFML has previously been set at a rate of 0.045 cents per litre. This rate was removed by the Amendment Act, which now specifies that the levy is payable “at the rate prescribed ... for each complete litre of petroleum or engine fuel of a type specified in regulations ...”⁵ As the PEFML will now also recover the costs of New Zealand’s IEA oil stockholding obligations, which are likely to change yearly, we propose using a formula to calculate the new levy rate, rather than a fixed figure.
31. Ticket contract prices vary year to year depending on the state of the oil market when New Zealand goes to tender, on the volume that New Zealand tenders for, and on the exchange rate. New Zealand goes to tender in January each year for ticket contracts that run for one year from April to March.

Options

32. We propose to set the levy rate so that the annual levy revenue received approximately equals the annual costs of meeting the IEA obligation (namely the annual cost of purchasing tickets) plus the existing levy amount. This approach would require the levy rate to be recalculated periodically, in response to the changing cost of tickets and changing volumes of fuels levied.
33. The options we have considered for the frequency of levy rate recalculation are:
- Every year.
 - Every three years.
 - Every five years.

Option One: the levy rate covering the IEA obligation costs is recalculated every year

34. Calculating the levy rate every year would help to ensure that costs are neither over nor under collected. However, the costs associated with changing the levy every year, while unlikely to be prohibitive, may mean additional annual compliance costs on oil companies subject to the levy, and administrative costs to government.

Option Two: the levy covering the IEA obligation costs is recalculated every three years

35. Our preference is for a nominal three year (36 month) period over which to adjust the levy rate, which will smooth the cost of ticket contracts over that period of time. The levy rate could be updated, if necessary, if forecasts of ticket contract costs change materially during the period. Future period levy rate changes should take account of any surpluses or deficits from previous periods (“wash-ups”). The advantages of this approach include:
- Certainty for the government in managing its revenue; and
 - The levy rate will not necessarily change from year-to-year which will reduce compliance costs for oil companies subject to the levy and for Customs, which is responsible for collecting the levy.

⁵ Energy (Fuels, Levies and References) Amendment Act 2015, section 5

Option Three: the levy covering the IEA obligation costs is recalculated every five years

36. Another option is to smooth the rate over five (or more years). This is not our preferred option because ticket contract prices vary depending on a number of factors including the state of the oil market and exchange rate. It is difficult to get a reasonably accurate forecast of oil ticket contracts five years out. This would increase the chances of having to adjust the rate part way through the five year period in the case of gross under or over collection. Additionally, it is good practice for levies to be reviewed at least every three years.

Q3) Do you agree that the levy rate for recovering IEA obligations should be nominally reset every three years? Why or why not?

Calculation methodology

37. We propose that the levy rate should be nominally reset every three years and should be calculated using the following formula:⁶

$$\text{Rate} = \frac{\text{Forecast cost of meeting the obligation for the levy period} - (\text{or} +) \text{surplus (or deficit)}}{\text{forecast fuel demand for the period}}$$

In this formula:

- 'Levy period' means a specified period of time such as 1 July 2016 to 30 June 2019.
- 'Forecast cost' must not exceed the appropriation set out in the Estimates of Appropriation for the purposes of meeting the costs of the IEA obligation in the levy period.
- 'Surplus' (or deficit if cost exceeds receipts) means the accumulated difference between levies received and the cost of meeting the IEA obligations.

38. The government would endeavour to align any change in the levy rate with other changes in fuel taxes such as excise duty. This would help reduce compliance costs for businesses.

39. We estimate that the increased levy rate for the first three year period would be approximately 0.18 cents per litre⁷ so the new levy rate will be 0.225 per litre.

Q4) Do you agree with the calculation methodology? Why or why not?

Notification

40. Customs will publicise any new rate through its website and weekly online newsletter *Customs Release*.

⁶ The Amendment Act specifies that the increased levy can be collected from 1 July 2013 (section 14(3)). Actual costs to date (1 July 2013 to 31 March 2016) are \$13,470,962. The first levy period takes this deficit into calculation.

⁷ The calculation of this levy rate is sensitive to forecasts in domestic oil production, domestic oil demand, ticket contract prices, and the USD/NZD exchange rate.

Annex 1: Tariff items and excise items subject to the petroleum and engine fuel monitoring levy

Tariff item	Description	Unit
2207.20.23 00K	Ethyl alcohol denatured, blended with ethyl ether, benzol etc. further blended with motor spirit as a fuel for engines	per litre motor spirit
2207.20.27 10B	Ethyl alcohol denatured, blended with ethyl ether, benzol etc further blended with automotive diesel as a fuel for engines	per litre
2207.20.27 13G	Ethyl alcohol denatured, blended with ethyl ether, benzol or further blended with marine diesel as a fuel for engines	per litre
2207.20.27 15C	Ethyl alcohol denatured, blended with ethyl ether, benzol or further blended with biodiesel as a fuel for engines	per litre
2207.20.27 19F	Ethyl alcohol denatured, blended with ethyl ether, benzol, further blended with substances as a fuel for engines	per litre
2207.20.35 00H	Ethyl alcohol denatured, blended with ethyl ether, benzol etc. further blended with motor spirit as a fuel for engines	per litre motor spirit
2207.20.37 10H	Ethyl alcohol denatured, blended with ethyl ether, benzol etc further blended with automotive diesel as a fuel for engines	per litre
2207.20.37 13B	Ethyl alcohol denatured, blended with ethyl ether, benzol or further blended with marine diesel as a fuel for engines	per litre
2207.20.37 15J	Ethyl alcohol denatured, blended with ethyl ether, benzol or further blended with biodiesel as a fuel for engines	per litre
2207.20.37 19A	Ethyl alcohol, denatured, blended in ways, not for manufacture, blended with substances as a fuel for engines	per litre
2710.19.13 00C	Motor spirit (not for manufacture), in bulk in ships etc., Research Octane Number (RON) less than 95 (regular grade), blended with ethyl alcohol	per litre motor spirit
2710.19.15 00F	Motor spirit (not for manufacture), in bulk in ships etc., RON 95 or greater (premium grade), blended with ethyl alcohol	per litre motor spirit
2710.19.21 10C	Motor spirit; (not for manufacture), in bulk in ships etc, RON less than 95 (regular grade), not blended with ethyl alcohol	per litre
2710.19.21 17L	Motor spirit (not for manufacture), in bulk ,other, RON 95 or greater, (premium grade), not blended with ethyl alcohol	per litre
2710.19.25 00A	Motor spirit; (not for manufacture), in containers less than 5 litres, RON less than 95 (regular grade), blended with ethyl alcohol etc.	per litre motor spirit
2710.19.27 00D	Motor spirit; (not for manufacture), in containers less than 5 litres, RON 95 or greater (premium grade), blended with ethyl alcohol	per litre motor spirit
2710.19.39 10K	Motor spirit (not for manufacture), in containers of less than 5 litres, RON less than 95 (regular grade), not blended etc.	per litre
2710.19.39 19C	Motor spirit (not for manufacture.), in containers of less than 5 litres, RON 95 or greater (premium grade), not blended etc.	per litre
2710.19.62 00D	Other distillate fuels, automotive diesel not blended with other substances, for other than manufacture etc.	per litre
2710.19.64 00G	Other distillate fuels, automotive diesel blended with motor spirit, for other than	per litre motor

	manufacture etc.	spirit
2710.19.66 10G	Other distillate fuels, automotive diesel blended with biodiesel, for other than manufacture etc.	per litre
2710.19.66 15H	Other distillate fuels, automotive diesel blended with ethyl alcohol, for other than manufacture etc.	per litre
2710.19.66 19L	Other distillate fuels, automotive diesel blended with other substances other than motor spirit etc, for other than manufacture	per litre
2710.19.68 00B	Other distillate fuels, marine diesel not blended with other substances, for other than manufacture etc.	per litre
2710.19.70 00G	Other distillate fuels, marine diesel blended with motor spirit, for other than manufacture etc.	per litre motor spirit
2710.19.72 10G	Other distillate fuels, marine diesel blended with biodiesel, for other than manufacture etc	per litre
2710.19.72 15H	Other distillate fuels, marine diesel blended with ethyl alcohol, for other than manufacture etc.	per litre
2710.19.72 19L	Other distillate fuels, marine diesel blended with other substances other than motor spirit etc, for other than manufacture	per litre
3824.90.87 00G	Ethyl alcohol blended with motor spirit and that can be used as a fuel for engines etc.	per litre motor spirit
3824.90.89 10G	Ethyl alcohol; blended with automotive diesel and that can be used as a fuel for engines etc.	per litre
3824.90.89 11E	Ethyl alcohol; blended with marine diesel and that can be used as a fuel for engines etc.	per litre
3824.90.89 13A	Ethyl alcohol; blended with biodiesel and that can be used as a fuel for engines etc.	per litre
3824.90.89 15H	Ethyl alcohol; blended with other substances other than automotive diesel, marine diesel or biodiesel used as a fuel	per litre
3824.90.93 00G	Ethyl alcohol, blended with ethyl ether, benzol etc, not for manufacture, etc., other, further blended with motor spirits as a fuel	per litre motor spirit
3824.90.94 10L	Ethyl alcohol, blended with ethyl ether, benzol etc., not for manufacture Etc, further blended with automotive diesel	per litre
3824.90.94 13E	Ethyl alcohol, blended with ethyl ether, benzol etc., not for manufacture etc, further blended with marine diesel	per litre
3824.90.94 15A	Ethyl alcohol, blended with ethyl ether, benzol etc., not aviation spirit, further blended with biodiesel	per litre
3824.90.94 19D	Ethyl alcohol, blended with ethyl ether, benzol etc., not aviation spirit, other, further blended with other substances	per litre
3824.90.96 00F	Biodiesel; not blended with other substances	per litre
3824.90.97 00B	Biodiesel; blended with motor spirit	per litre motor spirit
3824.90.98 10F	Biodiesel; blended with automotive diesel	per litre
3824.90.98 13L	Biodiesel; blended with marine diesel	per litre
3824.90.98 15G	Biodiesel; blended with ethyl alcohol	per litre

3824.90.98 19K	Biodiesel; blended with other substances etc.	per litre
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Annex 2

