

Changes in taxation regime for red diesel

Feedback on Draft Guidance issued 15th October 2021

October 2021

techUK is responding on behalf of UK data centre operators, who maintain emergency generating plant to support business critical functions. For context please refer to the explanatory notes at the end regarding data centre functions and generator routines, or to the references provided.

We have reviewed the latest iteration of draft guidance. While most of the provisions are clear, there is one element that is causing our sector concern. This relates to the change of stance on fuel purchased in advance of the rule change, which is causing confusion. The legislation states:

3.13 In response to users raising concerns about their ability to run down fuel stocks in back-up generators, the government has decided to give HMRC officers the ability to disapply the liability to seizure where the user can provide evidence to satisfy officers that they have not built up their stocks or taken red diesel into the fuel system after the rules changed.

This clearly states that operators need to satisfy inspectors that they have not built up stocks (i.e. stockpiled) or taken red diesel on after the rules changed – i.e. April 2022

At the stakeholder meetings on 18th and 21st June concern was expressed that this provision was not adequately captured in the draft guidance issued earlier in June. Reassurances were made at the stakeholder meetings to the effect that operators could continue as normal but should not stockpile, or buy fuel in a way that could be perceived as stockpiling.

However the second iteration of draft guidance issued on 6th August appeared to contradict this, suggesting that operators should already be buying white diesel. It was also at odds with the wording in the legislation. We asked for clarificationⁱ but this was not resolved.

The subsequent iteration of the draft guidance on 15th October provided some very helpful clarification regarding legacy stock but also set a retrospective date by which operators should be buying white diesel.

We understand from the text that for emergency standby plant serving commercial premises red diesel (or other rebated fuel) purchased before 10th June 2021 can be used after April 2022. We very much welcome this clarification, which recognises that we, and others, maintain fuel stocks for emergency running which have been, and may continue to be, in place for many years.

However, the guidance now also states that red diesel (or other rebated fuel) purchased after 10th June can only be used under licence which will be subject to a number of conditions, including tax on that fuel being made up to the level of unrebated fuel. This poses a number of practical issues because, in the absence of published guidance, and in line with the understanding reached at the stakeholder meetings, operators have continued to top up with red diesel to replace fuel consumed by regular maintenance and testing activities.

Further clarification is urgently needed:

1. Does the 10th June deadline apply to when a fuel order was submitted, when the fuel was delivered or when it was paid for? An order could have been submitted in good faith before this date, but delivered afterwards.

2. Will licences be issued at corporate level, at site level, at storage unit level or some other level?
3. What will the criteria be for a fuel user to be deemed eligible for a licence?
4. When will this information be published?
5. Where will it be published and how communicated?
6. How will operators apply? To whom?
7. What supporting evidence will be needed? by when?
8. Has HMRC conducted robust research on the number of licences likely to be needed?
9. Will HMRC have the necessary resource to produce those licences in a timely manner?
10. What will the appeal process be and how will it be arbitrated?
11. Does HMRC intend to charge for the licences as well as the tax difference?
12. Has HMRC published a new Regulatory Impact Assessment to reflect the additional administrative costs that this proposed licensing approach will impose, compared to the increase in tax revenue this is likely to generate? If so, where can this be found?

Our position is that backdating a requirement in this way feels worryingly like a case of regulatory overreach. If such an approach were imposed on consumers instead of businesses, and drivers were obliged to pay retrospective duty on the fuel in the tanks of their vehicles following a tax change at the pumps, there would be significant resistance and it is likely that HMRC would be subjected to ridicule in the press. Observers might also ask where such a step might lead – will homeowners be subjected to retrospective additional stamp duty for instance?

The current Regulatory Impact Assessment would presumably be invalid if this approach is pursued, because it ramps up the administrative burdens on businesses, none of which are reflected in the current iteration, which states: *“This measure is expected to have a negligible administrative impact on those businesses and civil society organisations that will lose their entitlement to use red diesel and will need to switch to white diesel, although it will increase their fuel costs”*. Discussions with industry should already have alerted policymakers to omissions in the RIA.

Proposed solution

As it happens, operators within our sector are already working towards a date of 1st January 2022 to change their purchasing from rebated to unrebated fuel and we propose this as a fairer, more transparent, and more pragmatic solution. The advantages of setting a compliance date in future, rather than in the past, include the following:

- 1st January 2022 is well ahead of the deadline and demonstrates early compliance with the requirements.
- There would be no need to establish a whole new bureaucracy to administer licences – everyone would simply have to comply by the date.
- Inspectors would still be able to ask for evidence that operators have not been stockpiling ahead of this date, so there would be no loss of transparency.
- There would be no need to produce a new Regulatory Impact Assessment.
- Operators can budget for the tax changes as part of their planning for the next financial year. HMRC is presumably aware of the current challenges that fuel pricing is imposing on energy intensive industries.
- Everybody will have certainty: operators will not be waiting for licences and wondering whether they will receive them in time – or at all.
- Confusion over order dates and delivery dates can be resolved in advance because everyone will know the date they are working towards.

- Finalising the guidance before the compliance date has passed is logical: currently the guidance that explains how the new rules will be applied in practice remains in draft. The date by which requirements must be met should surely follow publication of the final guidance, not precede it.

Other points requiring clarification

The guidance suggests that operators deploying plant for STOR (short term operating reserve) and/or FFR (Firm Frequency Response) can continue to use red diesel. Please could you clarify the conditions?

This is being presented as an environmental measure, but if the intention is to reduce reliance on fossil fuels in order to tackle climate change and reduce emissions, why is HVO more highly taxed than diesel, and why are fuel users not being incentivised to adopt biofuel alternatives?

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Consultation timeline

- Initial consultation: <https://www.gov.uk/government/consultations/consultation-on-reforms-to-the-tax-treatment-of-red-diesel-and-other-rebated-fuels>
- Our consultation response, October 2020: <https://www.techuk.org/asset/81075BA6-F93C-45FE-8200775C6265E999/>
- Draft Guidance June 2021: <https://www.techuk.org/asset/87C8A742-EF34-4D2A-B0C8DDE4BE40DCC9/>
- Draft Guidance August 2021: <https://www.techuk.org/asset/7287DBDD-1DE6-4FA1-B2966341CBF534C1/>
- Draft Guidance October 2021: <https://www.techuk.org/asset/6AEB8025-4804-4A40-A6CD7064172FAB18/>

More information:

- Emergency Generation in Data Centres: <https://www.techuk.org/asset/B99C277D-7933-4C90-8EF0CBCD3B49B520/>
- Data Centre Index: <https://www.techuk.org/data-centres-programme/data-centres-resource-index.html>

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Explanatory notes: Data Centres

Data centres store, process and transmit digital data. By doing so they provide business continuity for organisations across the whole economy by supporting critical IT functions. In order to guarantee continuous running in the case of grid outages or fluctuations in frequency, data centres are characterised by significant embedded emergency generating capacity (aggregating to perhaps 3GW nationally) combined with extremely low generating activity. This capacity takes the form of diesel plant usually combined with batteries: batteries provide instantaneous supply for a short period (usually about 30 seconds) while the generators fire up. This emergency supply is deployed only in the event of grid failure, which fortunately is rare. Even with regular testing, these generators are unlikely to run more than 12 hours a year.

Data centres need emergency generating capacity because they house ICT equipment that cannot tolerate interruptions in electricity supply or fluctuations in frequency. Data centres are usually required to maintain sufficient fuel on site to support continuous operation for between 36 and 72 hours, depending on the resilience rating of the site and customer service level agreements. Data centres therefore maintain substantial diesel stocks. Fuel is polished regularly but this process extracts fuel, filters it and restores it to the existing tank using a closed loop system. The smallest site we are aware of holds 27,000 litres on a permanent basis and another site reports 250,000 litres. Some operators hold well over a million litres spread across multiple sites. In aggregate, at national level, the quantity of fuel currently being stored is in the tens of millions of litres. The use of red diesel is widespread within the sector.

Operators consume some fuel during testing and maintenance routines. This consumption is generally predictable and fuel purchased to top up tanks generally replaces that used for regular maintenance. There is minimal scope for operators to stockpile because fuel stocks have to be maintained to meet resilience requirements and the testing and maintenance activity only has a marginal impact.

The only time that more significant volumes of fuel are purchased would be when commissioning new plant or following (or during) a major grid outage. Outages are rare, but operators cannot predict when they might occur. So a data centre operator does not know for certain when or whether they will use their emergency stocks. It is illegal for operators to run plant electively (i.e. other than for testing or emergency) and emptying tanks compromises resilience.

Endnotes

ⁱ *Our request for clarification of the August guidance ran as follows: “The problem for us is that until the guidance is finalised, I’m struggling to know how to brief our operators. At the meeting it was implied that operators could continue to fill as normal but must not do anything that could be construed as stockpiling. This has clearly changed in the most recent draft from “don’t stockpile” to “don’t buy red diesel if you don’t think you can use it by 1 April 2022”. While our operators are likely to use the quantity of red diesel that they are currently topping up with before the deadline, the tanks are already full of red diesel, and they won’t use all of that for sure. They use minimal amounts because generators are usually only run for testing but must keep 3 days supply on site in case of grid failure – hence the regular topping up. So we need to define a point in time after which they need to switch their purchasing and the sensible point would be after you have published your formal guidance. The addition of the sentence I have highlighted adds uncertainty and until the guidance is formally published the way that the rule changes will be implemented in practice has not been confirmed. On the whole the guidance is really well written and in all other respects, very clear and, to be honest, miles better than most government guidance relating to generators which is completely incomprehensible. So I’m really just trying to resolve this one aspect. When you have published I still need to develop sector specific guidance and then socialise the industry so that operators understand their obligations under the new regulations. They are not going to empty their tanks of red diesel between now and the deadline or run them down – as accepted this would be impractical, costly, dangerous, environmentally damaging and would also compromise resilience of critical functions. What they do need is certainty regarding the point at which they need to change supply.*

The other core anxiety which is not resolved by the guidance is future proofing against the very real problem of institutional amnesia. Bar a zombie apocalypse or similar, there will still be residual traces of red diesel in those tanks well into the future, probably for decades, which was why we were really pleased to see no deadline being imposed. However, an inspector in 2035 may not have been part of this exercise and may take a dim view of red diesel traces in tanks, so again we need a clear statement that can be used as a reference point.”