

Changes in taxation regime for red diesel

BRIEFING NOTES FOR DATA INFRASTRUCTURE OPERATORS: Updated 24 Jan 2022 to include clarifications from HMRC on tanks (point 10)

These briefing notes relate to the changes in taxation of red diesel, confirmed in the Finance Act 2021 on 10th June 2021 and due to take full effect from 1 April 2022. They apply ONLY to data infrastructure operators for whom certain specific concessions have been made in the legislation to reflect their critical functions and the necessity to store large volumes of fuel on site. If you do not run data centres and your fuel oil is not purchased for emergency generation to ensure continuous running of ICT infrastructure then these guidance notes do NOT apply to you.

NB: These notes summarise our understanding from dialogue with HMRC and do not constitute legal advice. If in doubt on any point, please check directly with HMRC at oils.policymail@hmrc.gov.uk.

See also these useful slides from HMRC: <https://www.techuk.org/asset/610F611B-C089-4A6F-826531599147F33C/>

Context

Red diesel, which is taxed at a lower rate than white diesel, has been used for a wide range of business activities that do not make use of roads. Data centre operators have therefore been eligible to use red diesel in emergency generating plant. The changes narrow eligibility to fewer uses, principally farming and non-commercial heating. The use of red diesel elsewhere will be prohibited from 1st April 2022. Data centres are not among the sectors eligible to use red diesel after April 2022 so must switch to white diesel.

Prohibiting the use (as opposed to the purchase) of red diesel from 2022 presents significant challenges to data centre operators who have large stocks on site but consume diesel slowly. Running storage tanks down compromises business continuity and legislation prevents the generators from operating other than for testing and emergenciesⁱ. The links at the end of this document set out the sector position.

These concerns were accommodated in the legislationⁱⁱ and Government guidance is available [here](#). This should be your first port of call. HMRC has also produced a useful briefing covering the rules for emergency plant operators which you can find [here](#).

The notes below are the result of discussions with HMRC and other stakeholders. The objective is to answer some of the many questions that have been received from operators and to clarify the way that concessions and obligations will apply in practice in a data centre setting. They are not definitive and may be updated or amended as more information becomes available.

Summary of Provisions specific to data centre operators

1. Red Diesel purchased before 10th June 2021 can be used after 1st April 2022 and there will be no additional duty to pay. This reflects the fact that the fuel was purchased in good faith, the practical difficulties of removal, and that data centres must hold significant permanent stocks to ensure continuity of services.
2. Operators do not need to empty fuel tanks of red diesel or flush tanks out before 1st April 2022.
3. Red diesel purchased on or after 10th June 2021 to top up tanks (eg to make up for maintenance or other running) and consumed by 31st March 2022 will not be subject to further taxation.
4. Red diesel purchased on or after 10th June 2021 that is not consumed by 31st March 2022 can only be used from 1st April 2022 under licence, and tax will be due on this fuel, equivalent to that payable on white diesel.
5. For data centre operators, fuel purchased before 10th June is treated slightly differently to fuel bought after 10th June. Essentially a line is drawn under pre-June purchases. The necessity to use the fuel by 31st March 2022 applies only to that fuel purchased on or after 10th June.
6. Simplistically this means that if your stock of fuel on 31st March 2022 is more than your stock of fuel on 10th June 2021, then you have to demonstrate that full tax has been paid on the difference. If you can show you bought an equivalent quantity of white diesel no further tax is due. If not, you need to licence and pay back-tax to make up the shortfall. For example: *an operator has 30,000 litres of rebated (red) diesel on site on 9th June and buys another 10,000 litres of red diesel in July 2021, then subsequently uses 1,000 litres a month for testing, by 31st March they will have used 8,000 of that additional fuel and will need to licence and pay tax on (or sell) the remaining 2,000 litres.*
7. If required by inspectors, operators must be able to evidence fuel stock levels at 10th June 2021 and at 31st March 2022. They should also keep good records of fuel purchases, for instance order confirmations and invoices. Robust evidence of transactions and stock levels will be needed to enable inspectors (and operators) to assess tax liabilities.
8. Obtaining a licence is non-trivial and is viewed as a last resort. Operators should therefore switch to white diesel far enough ahead of the April 2022 deadline to ensure that any rebated fuel purchased since 10th June has been consumed. It is likely that the licensing process will be more onerous than selling surplus red diesel to a reputable dealer. Operators who are concerned that they will have a problematic quantity of red diesel on site on 1st April should contact: oils.policy@mail.hmrc.gov.uk to discuss their options.
9. Tax is applied at corporate level, so if you have a surplus of red diesel on one site and can make use of it on another, you can transfer it. It has to be within the same corporate entity though.
10. HMRC make a distinction between fuel stored separately from generators and fuel they consider to be “in” the generator. Fuel in the generator is considered to have been used (and therefore may be used up without penalty after the 1st April 2022 even if purchased after 10th June 2021). Fuel that is immediately available to the machine is also considered to be “in the machine”. Think of a car with fuel in the tank. This fuel is considered to be in the vehicle. The car will run until the tank is empty. Fuel that needs a manual or electrical switch or signal in order to be released into the machine is not considered to be “in” the machine because it is not “immediate supply”. This gets complex because of the different configurations, which usually

include some or all of these listed below: NB: we now include clarifications made by HMRC in January 2022. See text in red italics.

- Belly tanks and day tanks: these are considered to be an integral part of the generator: HMRC comment: *“provided the machine draws its fuel from these when operating”.*
- Immediate supply: stand-alone tank(s) permanently connected to the generator fuel system that require no switching or change-over valves to supply fuel to the generator – likely to be viewed as part of the machine but you should be prepared to demonstrate this. HMRC comment: *“Our first impressions are that you could not use rebated fuel for this but it depends, does the machine draw its fuel from here while in operation or are these supplying the tank it draws fuel from? i.e. if these sense the machine’s fuel tank is getting low, do they automatically (e.g. computer-controlled) supply it with more so it doesn’t run out? If so, they are not the supply the machine draws fuel from so we could not allow”.*
- Reserve tanks: stand-alone tank(s) permanently connected to the generator fuel system but require switching or change-over to supply fuel to the generator – unlikely to be considered part of the machine unless you can demonstrate to the contrary. HMRC comment: *“As above, the only difference appears to be how these tanks supply the running tank – automatic or manually operated. In either case, they don’t sound like the tank from which the machine draws its fuel – instead they are how that tank is kept supplied with fuel.”*
- Storage: bunker fuel tanks not connected to any generator system requiring fuel to be decanted for distribution to satellite sites. These will not be considered to be part of the machine. HMRC comment: *“We would not permit this as a use which could use rebated fuel– this could only apply to fuel obtained before 11 June 2021.”*

The key requirement is that, in the event of an inspection, you can demonstrate that rebated fuel in a tank was either purchased before 11 June 2021 or is “immediate supply” which means a) the tank is a permanent part of the generator fuel system and b) no switching or change-over valves are required to supply fuel to the generator.

The key phrase in the legislation is: *“a substance is taken into a vehicle, vessel, machine or appliance as fuel, or as an additive or extender in any fuel, if (and only if) it is taken into the vehicle, vessel, machine or appliance as part of the supply—(a) from which the engine provided for propelling the vehicle or vessel or, as the case may be, for powering the machine or appliance, draws fuel.”*

FAQs : Frequently Asked Questions

See also: these useful slides from HMRC here: <https://www.techuk.org/asset/610F611B-C089-4A6F-826531599147F33C/> (Compliance section of the DC Index)

Q1: Is there a time limit for us to use up stocks of red diesel put in tanks before June 2021

A: No – HMRC recognised that diesel in place for emergency use may take many years to consume.

Q2: Can white diesel be added to existing stocks of red diesel in tanks and then the mixture used up in the normal course of activity?

A: Yes

Q3: Will fuel stocks be calculated on a per site basis or a company basis?

A: Tax is payable on a company basis so the aggregate fuel stocks will be used, but operators should still monitor fuel stocks at site level.

Q4: If we used fuel for an emergency after 9th June 2021 can we re-stock with red diesel?

A: You can only re-stock with red diesel if you are confident you will use it up before 31st March 2022. The same applies to any fuel purchased after 10th June. The level in the tanks on 10th June is not the indicator - the important thing is when the fuel was purchased.

Q5: Won't the requirement to use up red diesel stocks by the deadline act as an incentive to increase use?

A: Not really; paying the tax differential between red and white is much less costly than using more red than you need and then replacing it with white because you will have to pay both the commodity cost plus full tax on the white, not just the difference. Operators are also under strict regulatory controls (MCPD and IED) regarding elective running of generators.

Q6: By storage, do we mean storage tanks or generator belly tanks?

A: Belly tanks and day tanks are regarded as part of the generator and are distinct from storage tanks. Fuel in the belly/day tank is considered to have been taken into the machine.

Q7: What if we ordered fuel before 10th June 2021 but it was delivered on or after 10th June 2021?

A: In the guidance, "Purchased by" means "Ordered by", so if the order was placed before 10th June 2021 then the purchase is considered to be before this date, even if the fuel was delivered later.

Q8: What about our on-premise data centres and comms nodes? We have generator backup to provide continuity of service for those. Do these rules also apply here?

A: Provided that your back-up generators are in place specifically to provide contingency power to support critical IT functions then it is likely that the same rules apply but you should check this. You will need to evidence this.

Q9: If back-tax is due, when will it be payable?

A: 1st April 2022

Q10: What does the licence process entail?

A: Further information must be obtained from HMRC: oils.policymail@hmrc.gov.uk

Q11: Who is actually liable for the tax? The operator? The FM provider? The customer?

A: Whoever owns and operates the machinery. If this is different, then whoever owns the machinery or has leased it. Usually it would be whoever normally orders and pays for the fuel.

Q12: What is the tax liability when a site is divested but there is red diesel in storage purchased before June 21 that has not been consumed?

A: This depends on whether the site is purchased for data centre use or by a sector eligible to use red diesel. The pre-June 2021 exemption for stored fuel is only applicable to data centres. You would need to alert purchasers to this potential liability as you are in effect selling them the fuel, and there is an obligation on fuel suppliers not to sell red diesel to those ineligible to use it.

Q13: What is the tax liability when a site is divested but there is red diesel in storage purchased after June 21 that has not been consumed.

A: Again, this depends on the eligibility of the purchaser. If it will continue as a data centre, the rules above will apply to the new operator. Although this should be covered under due diligence on behalf of the buyer, you have a responsibility to alert the purchaser to the fact that there is rebated fuel on site and that a tax liability may exist. This liability should be made clear in the contract.

Q14: In such a case, could we just sell the fuel separately?

A: Yes, this is covered in the HMRC guidance notes - it would need to be sold to a reputable supplier who could then re-sell it to an entity still eligible to use red diesel. A clear chain of custody for the sale is critical here. There are apparently unscrupulous actors in the market who will happily buy your red diesel, run it through cat litter and sell it back to you as white.

Q15: If we buy a new generator for an existing site, can we use up rebated fuel we have on that site in that new generator?

A: Yes, it doesn't matter which machine you use the fuel in, provided it is providing contingency power to support data centre business continuity.

Further information:

- HMRC guidance pages: <https://www.gov.uk/government/publications/changes-to-rebated-fuels-entitlement-from-1-april-2022>
- Red Diesel Tax Changes: HMRC Guidance for Contingency Generation: <https://www.techuk.org/asset/610F611B-C089-4A6F-826531599147F33C/>
- This guidance note: <https://www.techuk.org/asset/68F81282-B1A1-4160-A181F36C92E42B8E/>
- Gov.UK web pages on reform of taxation for red diesel: <https://www.gov.uk/government/publications/reform-of-red-diesel-entitlements/reform-of-red-diesel-and-other-rebated-fuels-entitlement>
- 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>

Consultation timeline

- [Initial consultation](#)
- [Our consultation response, October 2020](#)
- [Draft Guidance June 2021](#)
- [Draft Guidance August 2021](#)
- [Draft Guidance October 2021](#)
- [Our feedback on the October guidance](#)
- [HMRC Guidance November 2021](#)
- [HMRC Slides: Guidance for Contingency Generation, December 2021](#)

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Endnotes

ⁱ **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. 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.

ⁱⁱ *3.12 The government has also decided to stick with its proposal that end users will not be mandated to flush out the tanks of their vehicles or machinery as this can be expensive and this approach also avoids damage to the environment that could arise from the unsupervised and unsafe disposal of red diesel. However, the government expects users of vehicles and machinery losing their red diesel entitlement to ensure that they do not purchase red diesel for use from 1 April 2022 and run down their existing stocks before that date. Fuel put into these vehicles and machinery after that date will be liable for forfeiture and penalties as it will be illegal fuel use, and so end users should not be stockpiling fuel before April 2022.*

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. The government recognises that for some users, for example, a data centre that holds a 3-day supply of diesel in their generator in case of emergencies but may only use it for a few hours a year, their last purchase of red diesel may be some time before the tax change.