



INFORMATION, ANALYSIS  
AND ADVICE FOR THE PARLIAMENT

INFORMATION AND RESEARCH SERVICES

Bills Digest  
No. 119 2002–03

## Energy Grants (Credits) Scheme Bill 2003

ISSN 1328-8091

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Energy Grants (Credits) Scheme Bill 2003

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28 February 2003

## Contents

|  |    |
|--|----|
| Purpose .....  | 1  |
| Background .....   | 1  |
| The Diesel Fuel Rebate Scheme. ....                            | 1  |
| Economics of business use of diesel and excise .....           | 2  |
| Diesel and Alternative Fuels Grants Scheme .....               | 2  |
| Basis of policy commitment .....                               | 3  |
| Position of significant interest groups/press commentary. .... | 4  |
| Pros and cons .....  | 4  |
| ALP/Australian Democrats/Greens positions .....                | 5  |
| Main Provisions .....  | 5  |
| Parts 2 and 3. ....  | 5  |
| Part 4 .....   | 9  |
| Part 5 .....   | 9  |
| Concluding Comments .....                                      | 10 |
| Constitutional Issues .....                                    | 11 |
| Endnotes. ....   | 11 |

# Energy Grants (Credits) Scheme Bill 2003

**Date Introduced:** 13 February 2003

**House:** House of Representatives

**Portfolio:** Treasury

**Commencement:** 1 July 2003

## Purpose

To replace the Diesel and Alternative Fuels Grants Scheme and the Diesel Fuel Rebate Scheme with the Energy Grants (Credits) Scheme.

## Background

### The Diesel Fuel Rebate Scheme

The Diesel Fuel Rebate Scheme (DFRS)—which is also called the off-road scheme—provides a rebate of the excise on diesel and like fuels used in certain eligible activities. Legislative authority for the DFRS is contained in section 78A of the [Excise Act 1901](#), section 164 of the [Customs Act 1901](#), and the regulations under those Acts.

The use of diesel and like fuels in the following activities is eligible for rebate subject to certain exemptions:

- mining operations (the use of any vehicle on a public road is not eligible)
- primary production, including forestry, agriculture and fishing (the use of a road vehicle on a public road is not eligible)
- at residential premises to generate electricity in the provision of normal domestic services
- at hospitals, nursing homes, homes for the aged and any other institution providing medical or nursing care
- rail transport in the course of carrying on an enterprise, and

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- marine transport in the course of carrying on an enterprise.

The current rebate rates are:

- for diesel and like fuels that attract the same excise rate as diesel fuel: 38.143 cents per litre, that is the full amount of the excise, and
- for like fuels that attract the lower rate of excise duty: 7.557 cents per litre.

### Economics of business use of diesel and excise

Diesel (and petrol) excise is levied primarily to raise revenue. But diesel excise is a tax on business inputs. Excise increases the cost of diesel that businesses use as inputs particularly in industries that use diesel relatively intensively. This increases the output prices of such industries relative to the prices of other industries. This, in turn, lowers demand for the output of the industries that use fuel relatively intensively, causing resources to leave. In other words, taxes on inputs such as diesel 'distort' consumption and production decisions.

This misallocation of resources would be eliminated if diesel used in business were not subject to excise or if the excise paid were rebated.<sup>1</sup> The DFRS offsets the excise *but only for selected industries*. The [Fuel Taxation Inquiry](#), which reported in May 2002, noted:

A wide range of off-road activities ineligible under the DFRS were brought to the Inquiry's attention. They include construction, manufacturing, quarrying, dredging, local government road construction and maintenance, extractive industries, cement, commercial electricity generation for remote communities, compost makers and organic farmers.<sup>2</sup>

The DFRS thus reduces but does not eliminate the misallocation of resources. Indeed, the DFRS compounds the misallocation in that it discriminates among activities *within* an industry. For example, in the forestry category, fuel used in milling timber is eligible but fuel used after that point in the production process is not.<sup>3</sup> Other industries bear the cost of favouring the selected industries and activities. The DFRS is thus inconsistent with the concept of a 'level playing field' among and within industries.

### Diesel and Alternative Fuels Grants Scheme

The Diesel and Alternative Fuels Grants Scheme (DAFGS)—also referred to as the on-road scheme—was part of *A New Tax System* changes. The Government originally intended to provide a 'diesel fuel credit' for the on-road use of diesel. But following agreement between the Government and the Australian Democrats to have the GST legislation passed in the Senate, the Government introduced the DAFGS. One of the agreed changes was to apply the scheme to alternative fuels.

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The Australian Taxation Office (ATO) administers the scheme under the [Diesel and Alternative Fuels Grants Scheme Act 1999](#).

The scheme's purpose is to reduce transport costs to business and particularly to benefit regional Australia. It provides grants for diesel and reduces the cost of alternative fuels such as ethanol, compressed natural gas and liquefied petroleum gas to maintain previous price relativities with diesel. The grant rates, effective from 1 February 2001, are:

- diesel: 18.510 cents per litre
- compressed natural gas: 12.617 cents per cubic metre
- liquefied petroleum gas: 11.925 cents per litre, and
- ethanol: 20.809 cents per litre.

Eligibility is for all business-related on-road use of diesel and alternative fuels in vehicles over 20 tonnes gross vehicle mass. Eligibility for vehicles between 4.5 and 20 tonnes depends on where the journeys are undertaken and the type of transport service provided. The grant is not available for journeys solely within major metropolitan areas. However, journey restrictions do not apply to vehicles transporting passengers or goods solely on behalf of a primary production business, buses using alternative fuels, and emergency vehicles. The eligible journey restrictions are intended to address concerns about air quality in large metropolitan areas. Further details of the scheme can be found in the [guide](#) on the ATO website.

The reason the DAFGS does not refund the entire amount of diesel excise—now 38.143 cents per litre—is that part of the excise (20 cents per litre) is notionally a road use charge for heavy vehicles.<sup>4</sup>

## Basis of policy commitment

The commitment to introduce an Energy Grants (Credits) Scheme [EG(C)S] was part of the Government's *Measures for a Better Environment* (MBE) statement in May 1999. The Government undertook to introduce an energy credit scheme that would provide price incentives and funding for conversion from the dirtiest to the most appropriate and cleanest fuels. The scheme's objectives were later refined, as set out in subsection 4(2) of the *Diesel and Alternative Fuels Grants Scheme Act 1999*, which states:

The purpose of the Energy Grants (Credits) Scheme will be to provide active encouragement for the move to the use of cleaner fuels by measures additional to those under this Act, while at the same time maintaining entitlements that are equivalent to those under this Act and the Diesel Fuel Rebate Scheme, including for the use of alternative fuels.

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The Government intended to introduce the EG(C)S by July 2002 but, in August 2001, deferred the start date to 1 July 2003.

## Position of significant interest groups/press commentary

According to a press report, the Bill has been criticised because it provides that the specification of grant amounts and the methods of calculating the quantity of fuel in certain circumstances will be specified in regulations. On the other hand, industry groups, notably the Australian Trucking Association, have welcomed the legislation.<sup>5</sup>

## Pros and cons

The Fuel Taxation Inquiry—whose recommendations the Government rejected on 14 May 2002—made a number of proposals as to what an EG(C)S should contain. The Inquiry found, among other things, that eligibility under the DFRS is arbitrary, inconsistent and confusing. The Inquiry noted the following about the submissions it received:

It was generally felt that there was no case for the Government to use the fuel tax system to advantage some business activities over others and that the lines of demarcation were completely arbitrary.<sup>6</sup>

The Inquiry recommended:

That off-road fuel credits should be paid to all businesses using any excised fuels, except petrol or petrol blends. The magnitude of these fuel credits to be equal to a full rebate of the fuel excise levied on these fuels.<sup>7</sup>

It should be noted that the Inquiry made this recommendation in the context of overall reform of the system of taxing fuels including the requirement that the Inquiry's recommendations be revenue-neutral. Adoption of this recommendation by itself would result in considerable revenue foregone.

With respect to the administrative and compliance costs of the DFRS and DAFGS:

... the Inquiry finds it hard to conceive of a more cumbersome and arbitrary set of administrative rules.<sup>8</sup>

The Inquiry also questioned whether the eligible journey restrictions in the DAFGS do much to improve air quality in large urban areas:

Transport is an integral element of business activity and businesses have few alternatives to the use of diesel trucks for the delivery of goods within urban areas. Consequently, higher diesel prices would be expected to be simply passed on to consumers. Nevertheless, the Inquiry sought further details from the Bureau of

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Transport and Regional Economics (BTRE) on this issue. The BTRE agreed that the use of diesel by businesses in 4.5 to 20 tonne vehicles was not significantly affected by diesel prices. It estimated that the increase in emissions from removal of the urban boundaries would be very small, approximately 0.1 per cent of road transport emissions.

In short, the DAFGS is doing little to improve air quality in large urban areas.

Further, contrary to conventional wisdom, the Inquiry found that:

Fuel taxes are not an appropriate mechanism to address many of the costs of fuel use, such as the costs of air pollution, road congestion, noise, road infrastructure and accidents.<sup>9</sup>

Rather:

The Inquiry considers that the Government's EGCS commitment to provide active encouragement to clean fuels should not be met through fuel excise but through separate measures specifically aimed at improving urban air quality. These measures should have the flexibility to target the most cost effective ways to improve urban air quality.<sup>10</sup>

## ALP/Australian Democrats/Greens positions

On 14 July 2001, the Shadow Minister for Transport, Mr Martin Ferguson MP, said that the ALP's position is to retain the benefits for the trucking industry under the DAFGS.

In May 2001, Australian Democrats Senator, Lyn Allison, issued a draft discussion paper that canvassed several alternatives for an ECGS. On 26 September 2001, Senator Allison referred to responses to the discussion paper in a [speech](#) in the Senate.

The Australian Greens support a substantial reduction in the rebates to the mining and forestry industries in their transport policy.

## Main Provisions

Parts 2 and 3

**Proposed Part 2** deals with interpretation. **Proposed Division 1** of Part 2 contains a list of definitions.

Eligibility for grants under the DAFGS depends in part on the gross vehicle mass (GVM) of the vehicle. **Proposed section 4** of Division 1 extends the definition of GVM to encompass situations where the manufacturer does not specify a vehicle's GVM or where

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the vehicle has been modified such that the manufacturer's specification is no longer relevant. Under section 4, when the vehicle is registered for use on public roads, the GVM is what the relevant vehicle registration authority determines is the vehicle's GVM (or gross combination mass). If the vehicle is not registered, the GVM is, in essence, the road weight or the sum of the weight of the vehicle and its maximum load.

**Proposed Division 2** covers definitions used only in relation to on-road credits. **Proposed section 8** defines incidental use, which relates to fuel used in powering the vehicle or auxiliary equipment:

- while goods or passengers are loaded and unloaded
- while the vehicle is moved to or from a place where loading or unloading occurs
- to maintain the quality of goods
- to maintain the vehicle or auxiliary equipment, and
- for use in training operators.

This provision extends somewhat the range of eligible activities. Its purpose is to redress anomalies in eligibility. The Fuel Taxation Inquiry identified many such anomalies. For example:

Other eligibility concerns related to the definition of road transport. For example, diesel used to power a refrigerated transport container carried on a truck is not eligible under the DAFGS because the container is not considered to be a vehicle. In contrast, a refrigerated trailer — which performs the same function as a refrigerated container — is classed as a vehicle and may qualify for a grant under the DAFGS. This is another anomaly which defies rational explanation and should be terminated.<sup>11</sup>

To qualify as an incidental use, the use must be integral to normal transport operations.<sup>12</sup> Time will tell how the proposed definition will be applied in practice. Incidental use is a concept that could well be 'stretched' resulting in an unintended widening of the term.

**Proposed Divisions 2 and 3** contain definitions used for the purpose of determining eligibility for on-road and off-road credits respectively. These Divisions largely replicate existing eligibility provisions under the DFRS and DAFGS. That is consistent with the Government's stated intent that the EG(C)S retain existing entitlements. There are, however, a number of changes notably in Division 3. They include:

- **proposed subsection 28(2)**: includes certain operations in the definition of 'agricultural activity' when a subcontractor undertakes those operations for a person contracted to carry out the activity
- **proposed subsection 34(1)(c)**: provides that the construction of ponds, tanks and other structures needed for fish farming is an eligible activity

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- **proposed subsection 34(2)**: extends the definition of 'fish' to include freshwater resources by adding the words 'of freshwater or below freshwater'
- **proposed sections 36 and 37**: define 'use in marine transport' while **proposed sections 38 and 39** deal with 'use in rail transport'. According to paragraph 1.41 of the Explanatory Memorandum, these sections have been inserted to remove uncertainty as to which activities are eligible and to align the administration of the marine and rail transport categories. **Proposed subsection 36(5)** includes forward and return journeys in 'use in marine transport' but **proposed subsection 36(7)** excludes dredging operations.

Dredging is presumably excluded on the grounds that dredging is not transport even though part of dredging usually entails moving dredged material from one place to another.

**Proposed Part 3** deals with entitlement to on-road credits.

'Entitlement' refers to: the requirement that claimants must be registered under the [Product Grants and Benefits Administration Act 2000](#) (**proposed section 41**); the category of vehicle; and vehicle use (the transport of goods and passengers and the carrying on of a primary production business). Paragraph 2.2 of the Explanatory Memorandum states:

Part 3 of the Energy Grants (Credits) Scheme Bill 2003 reproduces the entitlement provisions from the *Diesel and Alternative Fuels Grants Scheme Act 1999* for the purposes of the new scheme. Except for the changes ... the Government's intention is that the scope of the on-road credit will be the same as that of the DAFGS.

The major change aligns the point of entitlement under the on-road with the off-road point of entitlement. Paragraph 2.4 of the Explanatory Memorandum explains:

The major change to entitlement for an on-road credit in comparison with the DAFGS is that it will become prospective—that is claimants will be able to make a claim for an on-road credit in relation to fuel they have purchased or imported into Australia, that they propose to use in an eligible activity, but which may not have been used. Currently under the DAFGS the fuel must have been used before a claim for the on-road grant can be made. This will align the on-road credit with the situation as it currently stands for the DFRS, which will continue under the off-road credit. (**Clauses 42 to 47**)

Alignment is accomplished by the use of the words 'if you purchase, or import into Australia ... for use' that appear in **proposed sections 42 to 47**.

This change should streamline administration. It should also ease cash-flow problems for businesses that had to wait until they had used the fuel before claiming a grant.

For the purpose of on-road grants, vehicles fall into two categories:

- vehicles with a GVM of 20 tonnes or more, and

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- those with a GVM of 4.5 tonnes or more but less than 20 tonnes.

The general rule for the first category is that they are entitled to on-road credits if they are used in a business to transport goods or passengers on a road.

Proposed sections 42 to 47 define the circumstances under which vehicles in the second category are entitled to on-road credits. In essence, these circumstances are the transport of goods or passengers:

- in non-metropolitan areas (**proposed section 43**)
- for the purpose of primary production (**proposed section 44**), and
- on behalf of primary producers (**proposed section 45**).

(The issue of metropolitan areas is discussed below under 'Constitutional Issues').

Entitlement is also available to:

- buses using alternative fuels (**proposed section 46**), and
- emergency vehicles (**proposed section 47**).

Under the so-called 'stationary use' provisions of the DAFGS regulations, stationary use activities are generally ineligible for a grant where the stationary use is more than 20 per cent of total fuel use in a grant period.<sup>13</sup> The following example of stationary use is from the Fuel Taxation Inquiry:

The Australian Pre-mixed Concrete Association was also critical of the administrative complexity and unfairness of the DAFGS requirement to quantify the amount of diesel used when a vehicle is stationary, where this exceeds 20 per cent of the diesel used. Concrete vehicles may consume more than 20 per cent of fuel while unloading concrete at the delivery destination and while stopped in traffic in the course of their journey on a public road. The Association stated in their submission:

The combined effect of not providing a grant for off-road transport and the need to reduce the grant claim for stationary fuel use where that exceeds the 20 per cent threshold delivers an extremely complex compliance regime. In fact the compliance requirements are so complex that more than 21 months after the introduction of the DAFGS neither the APMCA's largest members nor the Australian Taxation Office has been able to devise an accurate method of quantifying the fuel that is claimable under the existing legislation.<sup>14</sup>

Proposed sections 42 to 47 entitle stationary use activities to on-road grants for both categories of vehicle by means of incidental use provisions such as **proposed paragraph 45(b)(ii)** which refers to 'incidental use in relation to such a vehicle'. However, under proposed section 42, for vehicles over 20 tonnes to be entitled to an on-road credit for all operations, they must be used to transport goods and passengers. If such vehicles are not

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thus used, entitlement is limited under **subsection 42(b)** and **subsection 42(c)** to the movement to or from the place where the vehicle is used. The example given in the Explanatory Memorandum is special purpose vehicles such as mobile cranes.<sup>15</sup>

Paragraph 2.9 of the Explanatory Memorandum notes that the Bill removes the requirement that DAFGS activities be conducted on a *public* road. Removing this requirement allows certain activities that are part of normal transport operations, such as those conducted on private access roads to mine sites, to be eligible for an on-road credit.

**Proposed section 49** complements the change from actual use to proposed use of fuel. It provides that claimants are not entitled to a grant if the fuel they bought was (a) used for a purpose other than the particular use for which it was bought, (b) sold or disposed of or (c) lost. The Explanatory Memorandum (at paragraph 2.12) states that proposed section 49 reproduces the current arrangement in the DFRS.

## Part 4

**Proposed Part 4** deals with entitlement to off-road credits.

**Proposed subsections 54(1) to (4)** transfer the eligibility of various activities under the DFRS, for example, mining operations and primary production, to the EG(C)S.

Under Customs Regulations 1926 and Excise Regulations 1925, there are a number of excise concessions and remissions that eliminate or reduce excise on petroleum products used in specific off-road activities, for example, furnaces, boilers or when used as a solvent in manufacturing processes. **Proposed subsections 53(5) to (6)** transfer these concessions and remissions to the EG(C)S. **Proposed subsection 53(7)** also provides for eligibility of certain diesel fuel for use other than in an internal combustion engine. The kind of fuel is to be specified by regulation.

The Fuel tax Inquiry recommended bringing the concessions and remissions into the EG(C)S.

## Part 5

**Proposed Part 5** deals with entitlements to an energy grant.

**Proposed section 56** provides that entitlement to an on-road credit or an off-road credit entitles the claimant to be paid an energy grant.

**Proposed subsection 57(1)** sets out the 'basic rule' for calculating grant amounts. In essence, this is the amount of fuel multiplied by the relevant grant rate, where the grant rate is specified in or calculated in accordance with regulations. **Proposed subsection 57(2)** provides that the regulations may specify different amounts for different types of fuel. **Proposed subsection 57(4)** provides that if actual use differs from proposed use,

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actual use is deemed to be proposed use. **Proposed subsection 57(5)** provides that the regulations may prescribe one or more methods of calculating (whether by measurement, estimate or any other means) the quantity of fuel that it is proposed will be used or actually used. Further, **proposed subsection 57(5)** provides that the methods may differ depending on a number of factors including how the fuel is used.

Readers are referred to the Bills Digest for the companion Energy Grants (Credits) Scheme (Consequential Amendments) Bill 2003 (Bills Digest No. 120, 2002–03), which amends various related Acts including the repeal of the DAFGS Act.

## Concluding Comments

The Government undertook to adopt measures to encourage the use of cleaner fuels, while maintaining entitlements in the EG(C)S that are equivalent to those under the DFRS and DAFGS. These schemes contain, among other things, incentives for the use of fuels other than petrol and diesel. But the EG(C)S Bill does not contain any new measures to adopt cleaner fuels. This seems to contradict the undertaking to introduce measures additional to those under the DAFGS Act.

With respect to the maintenance of entitlements, a key feature of the Bill is that it carries over, largely intact, entitlements under the DFRS and the DAFGS. The EG(C)S thus does not differ greatly from the DFRS and DAFGS.

The Fuel Taxation Inquiry in its proposals for an EG(C)S concluded:

Taxing all fuels on a consistent basis early in the fuel production and distribution chain, and providing taxation relief to business through a single fuel payment scheme, is the best way to promote the efficiency of the excise system as a revenue raising instrument. Such a system would also address administrative issues, such as excise evasion through fuel substitution.<sup>16</sup>

The Bill goes some way to meeting these criteria. For example, it eliminates the distinction between the points of entitlement under the DFRS (prospective) and the DAFGS (retrospective), and brings excise concessions and remissions that eliminate or reduce excise payments into the EG(C)S. In doing so, the Bill also simplifies administrative and compliance requirements.

On the other hand, while the Bill extends eligibility to some additional activities including incidental use, it does not address the underlying problems of those schemes. In particular, the DFRS discriminates against non-favoured activities that bear the cost of diesel excise. The EG(C)S therefore does little to reduce the misallocation of resources resulting from the imposition of excise of business inputs. The EG(C)S also retains most of the administrative and compliance complexity of the two schemes.

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Finally, given the Bureau of Transport and Research Economics finding that the increase in emissions from the removal of the urban boundaries would be very small—approximately 0.1 per cent of road transport emissions—it is doubtful whether the benefits exceed the costs of the DAFGS and hence the proposed on-road credits under the EG(C)S.

## Constitutional Issues

The [Bills Digest](#) for the Diesel and Alternative Fuels Grants Scheme Bill 1999 examined (in the 'concluding comments' section) various aspects of the constitutionality of that Bill. In particular, it examined whether the discrimination in favour of Tasmania in the definition of 'metropolitan areas' may breach the requirement of section 51(ii) of the Constitution that laws dealing with taxation shall not discriminate between States or parts thereof. The definition of metropolitan areas in the Energy Grants (Credits) Scheme Bill 2003 is the same as in the *Diesel and Alternative Fuels Grants Scheme Act 1999*.

## Endnotes

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- 1 Fuel Taxation Inquiry. *Report*, p. 130.
- 2 *ibid.*, pp. 121-2.
- 3 Additional examples can be found in chapter five of the *Fuel Taxation Inquiry. Report*, *op. cit.*
- 4 See Richard Webb, [Petrol and Diesel Excises](#), Department of the Parliamentary Library, Research Paper No. 6, 3 October 2001.
- 5 Allesandro Fabro, 'Fuel grant lacks detail, fume experts', *Australian Financial Review*, 21 February 2003, p. 8.
- 6 *Fuel Taxation Inquiry. Report*, *op. cit.*, p. 121.
- 7 *ibid.*, p. 147.
- 8 *ibid.*, p. 125.
- 9 *ibid.*, p. 130.
- 10 *ibid.*, p. 131.
- 11 *ibid.*, p. 124.
- 12 Explanatory Memorandum, paragraph 2.7.
- 13 Explanatory Memorandum, paragraph 2.7.
- 14 *Fuel Taxation Inquiry. Report*, *op. cit.*, p. 126.
- 15 Explanatory Memorandum, paragraph 2.8.
- 16 *Fuel Taxation Inquiry. Report*, *op. cit.*, p. 130.

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