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## **Inquiry into the provisions of the Fuel Tax Bill 2006 & a related bill**

### **RECOCHEM INC. SUBMISSION**

#### **Introduction**

Recochem Inc. supports in general the overall intent of the changes proposed in the Fuel Tax Bill 2006, namely to reduce the cost of compliance for the supply of basic hydrocarbon solvents and remove the excise from burner fuels while protecting government revenue from excisable uses of these products.

These proposed changes raise a number of concerns with Recochem Inc.

- The change to levying excise at acquisition, with excise free treatment being provided via credits claimable on BAS will have a substantial negative impact on cash flow & working capital due to the time lag inherent in the BAS return.
- The cost of compliance for Recochem and many of Recochem's customers may increase, cancelling the intent of the changes to reduce the cost of compliance.
- The assessment of non-excisable blends such as paint thinners which are unsuitable for use in Internal Combustion Engines needs to be simple and/or defined by the regulator.
- The assessment of products which could possibly be used as fuels in Internal Combustion Engines, but whose supply price is sufficiently higher than excise paid fuels to preclude their use in Internal Combustion Engines. This assessment needs to be simple and/or defined by the regulator.
- The position of recovery of excise from unrecoverable bad debts needs to be clarified.
- The mandatory membership of the Greenhouse Challenge Plus programme needs to be reviewed.

Most of our concerns deal with hydrocarbon solvents and will be discussed in more detail in the following pages. We understand that many of these concerns are similar for many other companies in our industry, including our customers & competitors.



## **Recochem Inc. Background**

Recochem Inc. is a privately owned company incorporated in Canada. Our Australian operation has annual sales of about \$A50 million and employs about 90 people around Australia. Bulk solvents, the subject of this discussion, are received, stored & packed at Lytton in Queensland and Kewdale in WA. Consumer solvents such as Kerosene, Methylated Spirits and Mineral Turps are packed into 1L & 4L packs at Lytton and distributed nationally via the Grocery & Hardware distribution channels. Larger pack sizes of these and more specialised solvents - drums, IBCs & bulk - are supplied by our Industrial Division in Qld, NT & WA.

We act as aligned distributors for Shell Chemicals Solvents & Manildra Ethanol in Qld, NT & WA.

## **Excise Levy**

We currently operate under a Continuing Permission and purchase all products excise free. Excise is charged by us on burner fuels (mainly kerosene) and remitted to ATO weekly. Industrial customers are supplied with bulk & IBC solvents under Remission Certificates or Continuing Permissions and marked when required. Currently excise is only levied on these transactions where the end use may be as burner fuels. Excise is not levied where the products are blended to make other products, such as hand cleaners, which are unsuitable for use in Internal Combustion Engines (ICE).

The proposed changes mean that we will pay excise on all incoming hydrocarbons at 38.143 cpl. With an average consumption of 1 million litres a month the excise will be about \$380,000/month. About half of this solvent is packed into small packs of 20L or less so the excise may be claimed back via our BAS monthly, building an inherent lag into the system.

The rest of the purchased solvent is on-sold in larger packs, bulk or used in blends and would be subject to the full excise when sold which Recochem would collect on behalf of ATO and remit on our weekly return. These customers operate on a 30 day account and many do not pay in less than 45 days. Thus Recochem will have remitted substantial amounts of money to ATO well before there is any possibility of recovery from our customers.

We estimate the impact of the change will be an increase in our average working capital requirement of about \$700,000 if the changes are implemented in their current form.

## **The Cost of Compliance**

It is accepted that the current system of Permissions, Certificates & Marker has a significant cost of compliance, though it only affects a relatively small number of customers since it only applies to bulk & IBCs. Pushing the volume down to > 20L containers captures many more customers – perhaps as many as 10 times the current number affected.

Our IT people have said that our computer systems will cope with another charge similar to GST, so the compliance cost to us would be mainly in financing the excise paid by us to ATO in our role as a distributor.



We are unsure of the compliance cost to ATO if the number of returns increases dramatically, or if a substantial number of businesses change from quarterly BAS to monthly BAS to obtain quicker returns.

## **Assessment of Non-Excisable Blends**

Many proprietary blends based on hydrocarbons are produced at our level in the distribution chain, as well as by other manufacturers. Paint thinners are a good example. Most are based on hydrocarbons which could probably be used in Internal Combustion Engines (ICE). Other solvents such as Methyl Ethyl Ketone (MEK) or Acetone are then added to improve performance with particular paints. These are powerful solvents which attack plastics, rubber and sealants – common components of ICE fuel delivery systems. The addition of a proportion of these and other powerful solvents would render such blends unsuitable for use in ICE.

Recochem currently makes about 150 blends to our own, or our customer's formulations. At least 80% of these blends would be unsuitable as fuel substitutes either because they would ruin engine components or cost much more than the equivalent transport fuel. Paint Thinners, Engine Degreasers, Blanket Washes for the printing industry, Tyre Shines and Timber Preservatives are typical blended products.

These blends need to be treated differently to those which would have no impediment to their use in ICE's.

## **High Priced Hydrocarbon Solvents**

A significant volume of specialty hydrocarbon solvents are used whose supply prices are higher than fuel prices. Examples are Shellsol/Solvesso 150 & Exxsol/Shellsol D80.

These solvents are all derived from oil, so their prices fluctuate with oil prices. At any point in time if their selling prices are higher than relevant transport fuel prices, they will remain higher than transport fuels.

The possibility of any volumes of these solvents being diverted to use in fuel is remote because of their cost, so the revenue is protected. Inclusion of these solvents as excisable adds cost without benefit.

## **Bankruptcy & Liquidation**

The proposed changes, if enacted in their current form, give distributors such as us a substantially higher exposure if a customer is declared bankrupt. Take the case of a customer who buys about \$100,000 – roughly 100,000L - a month. Credit exposure if they pay at 45 days will be about \$250,000 (current, plus 30 days terms, plus 15 days "slow payment"). They declare bankruptcy. We lose \$250,000, plus another \$100,000 in excise we have remitted, but not received from the customer. Losses of this magnitude have a significant impact on companies of our size. The excise magnifies them.

Under these circumstances the GST is currently refundable. Will the excise also be refundable?



## **Greenhouse Challenge Plus**

We can understand users of transport fuels and other companies who burn fossil fuels whose usage of such fuels exceeds an amount which generates excise refunds of \$3 million being required to join Greenhouse Challenge Plus – this is a substantial amount of fuel. GCP appears to be all about energy efficiency.

Recochem is a small industrial company. Apart from office accommodation our factory already runs with very high energy efficiency. We run a 35Kw gas fired boiler and about 25Kw of compressed air – hardly high energy usage.

As packers of solvents we already supply data on our plant emissions to the National Pollutant Inventory. These emissions account for less than 1% of the solvent packed in our plant.

Mandatory membership of GCP will not assist our energy efficiency if there is little energy to save.

## **Conclusion**

We hope you find our comments & recommendations constructive. We would also be pleased to work with Treasury & ATO to minimise the cost of compliance, while assisting to protect the revenue for applications which should attract excise.

DLP 23/5/2006