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31 May 2006

The Secretary
Senate Economics Legislation Committee
Suite SG.64, Parliament House
CANBERRA ACT 2600

Dear Sir/Madam

Inquiry into the provisions of the Fuel Tax Bill 2006

Thank you for the opportunity to input to the Senate Inquiry into the provisions of the Fuel Tax Bill 2006. The Plastics and Chemicals Industries Association (PACIA) is the peak national body representing the Australian chemicals and plastics sector.

PACIA supports the government's initiative to simplify the Fuel Tax System and to reduce compliance costs on business in claiming its fuel excise credits. PACIA appreciates the important benefits to industry from the relief from excise of a broad range of non-transport uses of liquid petroleum products. It recognises that the existing arrangements for differentiating effective excise impositions based on end use are complex, sometimes inconsistent, and often involve difficult and costly compliance requirements of users. On this basis, PACIA agrees that reform and simplification of the fuels excise regime is appropriate.

However, PACIA is concerned that under the proposed arrangements for claiming fuel excise credits, many businesses may suffer significant cash flow disadvantages. This is particularly true of businesses using fuel as a non-combustion input to production, as do many businesses in the chemicals sector which do not currently pay excise on fuels. The impact of this would be a loss of competitive advantage over imported products that would not be subject to this legislation (and to the cash flow and compliance costs that it would impose).

This submission:

- Provides background on the chemicals and plastics sector;
- Discusses why fuel use is a critical component of the industry;
- Examines the impacts to cash flow of the proposed method of claiming; and
- Discusses alternatives to the proposed approach to excise claims.

The Chemicals and Plastics Sector in Context

In 2002-03, turnover in these sectors was $32.5 billion, industry value added was $9.6 billion and wages and salaries were $4.7 billion. Employment at 30 June 2001 (the latest data available) in the sectors was about 81,000 persons. The chemicals and plastics sectors represent between 10 and 11 percent of total manufacturing activity.

Chemicals production is typically a high fixed cost and energy intensive manufacturing activity, and most chemicals products are extensively traded. International markets are sensitive to the business cycle, to oil prices and to changes in market supply conditions (the commissioning of a new large-scale plant can cause a surplus, and depressed prices, for several years). In this highly competitive market, it is commonplace for world prices to be at or near marginal cost of production for extended periods. Australian producers are particularly exposed to low-cost competition and the fluctuations of world markets, including extended periods of depressed prices.

Why is the issue of importance to PACIA?

The chemicals sector is a major user of petrochemical fuels as feedstock, as solvents and for energy. While the greater part of this consumption is of gaseous petroleum derivatives - ethanol, LPG, LNG and CNG - the use of a range of liquid petroleum and related products is substantial. For many important commodities produced by these sectors, these petroleum products represent a major factory input cost, a substantial part of the working capital and a high proportion of the costs of the goods produced.

In important parts of the chemicals industries where petroleum fuels are used - sealants, glues, inks and dyes, paints and surface coatings, fungicides, insecticides are examples - there is a significant representation of small and medium-sized enterprises (SMEs). These manufacturers will often require relatively small quantities of petroleum fuels and these are typically sourced from fuel distributors, not the major refineries.

Financing Additional Cash Flow and Working Capital Requirements

In PACIA's view, it is appropriate and relevant to examine the impact of the cash flow effects by considering the implications of the proposal that the terms of trade available to manufacturers do not involve any extended provision of credit - ie, that payment is required on, or within 5-7 days of, delivery/invoice. There are several compelling reasons to examine the cash flow implications on this basis:

- these are the terms that many SMEs already trade under;
- the massive increase in 'upfront' costs of petrochemical fuels flowing from the ‘up front’ payment of excise will change the financial risks associated with extended credit arrangements, and encourage tighter credit terms;
- wide acceptance of electronic banking reduces the utility of extended credit arrangements;
- to the extent that credit arrangements are of benefit to a purchaser, it is inappropriate that a 'black letter' tax liability diminish or vary that benefit, or assume that such credit arrangements will be maintained; and
- to the extent that extended credit could involve a cost (ie, an interest component) and this is inevitably reflected in prices, competitive pressures to lower or maintain prices will put pressure on extended credit arrangements.

Where extended credit is not provided in relation to fuel purchases, or where a business operates its accounts on a cash basis, the fuel purchaser will, typically, pay excise in one calendar month and only obtain a BAS credit late in the subsequent month. In this situation, the cash flow demand on manufacturers and the increase in working capital tied up in stock and work in progress, imposed by the Fuel Tax Bill 2006, will amount to two months of excise payments.

PACIA understands that, typically, financial institutions base their facilities to business customers on the maximum credit requirement in any month, even if this requirement is only for part of the month. Thus, for many chemical producers, the implications of the Tax Credit Scheme will be a requirement to substantially increase overdraft facilities. As the excise inclusive price of petroleum fuels can be as much as 50 percent higher than the excise-free price, the fact that excise will be payable up to two months before a BAS credit can be obtained will mean the working capital requirement each month will increase to as much as double the (excise-free) cost of the fuel inputs.

For an industry where earnings on sales are comparatively low (typically, about 5 to 10 percent when the market is buoyant), such an increase in working capital will place a considerable demand on cash flows and substantially erode profitability. During the trough of the business cycle, this cost imposition would add to unprofitability.

For the chemicals sector these demands on cash flow and working capital are critical. There can be no assurance that finance institutions will provide the financial resources to enable companies to increase their material input costs and working capital to this extent.

Alternative approaches

PACIA wishes to work with government to establish a practicable model, while remaining consistent with the 2004 Energy White Paper that stated '*excise credits will be claimable through the Business Activity Statement from 1 July 2006'.*

PACIA draws attention to an article in the Financial Review on 25 May 2006 'Coalition set to cave in on fuel tax rebate changes' (see Attachment 1), particularly the comments by Nationals Leader Mark Vaile, who said that

> *'… the government was looking for ways to ameliorate the delays in rebates under the new system. It might be a creative process of purchasing and claiming within the BAS system. We need to be sensitive to the impact on business, and work with businesses to find a system that does assist in those objectives.'*

PACIA supports this objective. The article draws attention to the potential cash flow implications for farmers, fishermen and rural industries. As noted above, the plastics and chemicals industries are no different. Any alternate model for claiming would need to meet the needs of all industries and not just some sectors.

There are a number of alternatives approaches that could be considered, such as (but not exclusively):

- The removal of existing exemptions should not proceed;
- The e-grant scheme could be extended to cover all affected businesses;
- Address the timing issues within the BAS system, such that claims can be prospective rather than retrospective, with adjustments made annually as appropriate. PACIA recognises that this approach may not be ideal in that it could effectively increase the compliance costs.

Conclusion

PACIA supports the government objective to simplify the Fuel Tax System and reduce compliance costs on business.

PACIA's principal concern is that the basic principle of the Fuel Tax Credit System - that excise tax is payable on all 'fuel' purchases, and these payments are refunded as a credit on the Business Activity Statement - represents a considerable and threatening financial impost on chemicals producers. Excise rates represent a significant proportion of the cost of excisable product, and the outlay of excise tax on the basis that it is recoverable up to two months later will increase cash flow requirements and add substantially to the costs of working capital. For important sectors of the chemicals industry, particularly those where there is a strong representation of SMEs, these increased costs could be critical to business survival, threatening viability and competitiveness with imports.

PACIA is also concerned that these issues relating to cash flow and working capital requirements will also affect fuel distributors upon which significant parts of the industry, particularly SMEs, depend for their feedstocks, solvents and energy sources. Significant disruption to the fuel distribution sector will have flow-on effects to chemicals producers.

To reiterate, PACIA wishes to work with government in the development of an appropriate mechanism to ensure that that the negative cash flow implications of the proposed scheme are ameliorated.

Should you wish to discuss these issues further, please contact me on (03) 9429 0670.

Yours sincerely

Michael Catchpole
Chief Executive

ATTACHMENT 1

Financial Review

Author: **Fleur Anderson and Tracy Sutherland**
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Section: **News**

Coalition set to cave in on fuel tax rebate changes

Prime Minister John Howard is understood to have bowed to complaints from farmers, fishermen and rural industries that a planned overhaul of fuel tax rebates would drive many businesses broke.

Mr Howard is expected to decide as early as next week how the government will amend its reforms to the fuel excise rebate scheme so that businesses no longer face being out-of-pocket for months, according to government sources.

A group of six coalition backbenchers sought a meeting with Mr Howard during budget week in early May to complain about the changes to fuel excise rebates on July 1, which will mean rebates worth tens of thousands of dollars for fishermen, farmers and some manufacturers could be delayed by as much as 12 months.

Nationals MPs have protested the changes on behalf of their constituents and Nationals leader Mark Vaile said yesterday business had "reasonable concerns" about the impact of the changes on their operations.

Mr Vaile said the government was looking for ways to ameliorate the delays in rebates under the new system.

"It might be a creative process of purchasing and claiming within the BAS system," Mr Vaile said.

"We need to be sensitive to the impact on business, and work with businesses to find a system that does assist in those objectives."

Under existing arrangements, primary producers can claim their refunds either at the point of sale through their fuel retailers or as soon as four days through an electronic form lodged with the Australian Taxation Office.

The rebate reimburses the 38.14¢ a litre excise for all off-road fuel used for business purposes.

But under a new system announced by Assistant Treasurer Peter Dutton on March 29, the rebate will be paid only after the businesses lodge a monthly or quarterly business activity statement in the same way businesses claim GST credits.

Treasury expects the new system will save businesses $80 million next financial year in red tape costs but Nationals MPs, who have campaigned against the changes, say many rural and regional businesses could go broke waiting for the rebate to be reimbursed.

Nationals senators Fiona Nash and Barnaby Joyce, Nationals MP and parliamentary secretary for trade De-Anne Kelly and Cairns-based Liberal MP Warren Entsch have all pushed the government to retain the old scheme.

Headline: Coalition set to cave in on fuel tax rebate changes
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