
HM Revenue and Customs

Energy Products Directive – expiry of the derogation for private pleasure boats

Consultation on the options for change
1 August 2007

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1. Introduction

Background

- 1.1. Until 31 December 2006, the UK held a derogation from the European Energy Products Directive (2003/96) which allowed the UK to charge a reduced rate of duty on fuel used in private pleasure craft. The derogation had in fact been time limited since the mineral oils directive, the predecessor to the EPD, was agreed and signed in 1992. In 2001, the UK negotiated an extension to the derogation to December 2006. A request to extend the derogation further was submitted in October 2006; however, this was rejected by the Commission and the derogation consequently expired on 31 December 2006.
- 1.2. The Commission argued that since the fuel had been taxable in principle since 1993, member states had had enough time to adapt to the requirements of community law. They stated that they did not accept the UK's argument that there would be additional administrative burdens or compliance costs resulting in the expiry of the derogations, and that if such arguments were to be accepted then the derogations would need to be maintained indefinitely, contradicting the principle that derogations are time limited and intended to assist with overcoming any initial difficulties encountered with the introduction of new regimes.
- 1.3. The Chancellor of the Exchequer announced at Budget 2007 that from the 1 November 2008 fuel used for these purposes would no longer benefit from these reduced rates. The Budget also announced that the Government would consult on the proposed changes and new procedures. The Government is obliged to introduce changes as failure to implement European legislation would leave the UK open to legal action the Commission.
- 1.4. Ministers have said that we would look for ways of implementing the new regime which would both minimise the impact, and ensure that any additional compliance burden was as small as possible. We, therefore, need to bear in mind that any proposed system must be proportionate to the revenue at risk and should recognise that
 - Private pleasure craft will continue to be able to use red diesel legitimately for purposes other than propulsion;
 - Private pleasure craft will be free to use red diesel bought from the Channel Islands;
 - Red diesel bought at the current rate will remain in tanks for long periods, and traces will remain even longer; and
 - There is a need to minimise any restriction on boat owners' ability to travel because of non – availability of fuel.

- 1.5. A similar consultation exercise is being carried out simultaneously on the implementation of new procedures following the expiry of the derogation that allowed the UK to apply a reduced rate of excise duty on aviation gasoline (Avgas) and exempt aviation turbine fuel (Avtur) from excise duty used for private pleasure-flying.

Purpose of this consultation

- 1.6. The purpose of the consultation is to
- Seek views on the options offered from boat owners, suppliers of rebated fuel and other interested parties.
 - Invite suggestions for change that meet the needs, and provide the necessary safeguards, for both business and HMRC.
- 1.7. In order to assist contributors we have identified a number of potential options for change, and would welcome views on the merits and drawbacks of each. These are not intended to restrict either debate or alternative suggestions for change.
- 1.8. Further copies of the consultation paper can be obtained from HMRC at the address given in paragraph 1.10 below, or via the HMRC website (www.hmrc.gov.uk).

How to respond

- 1.9. The specific issues on which your views are sought are highlighted in bold throughout this document, but a summary of these along with some questions on your own specific circumstances is at Annex A. Your views on other relevant issues would also be welcomed.
- 1.10. In accordance with Cabinet Office guidelines the consultation will run for 90 days. Comments should be received **by 31 October 2007** and should be sent:

by e-mail to: envirotax.bst@hmrc.gsi.gov.uk

or by post to: **Transport Taxes Team**
HM Revenue & Customs
3E/01, 100 Parliament Street
London SW1A 2BQ

or by fax to: **020 7147 0391**

Publication of responses

- 1.11. Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access

to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).

- 1.12. If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, among other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.
- 1.13. The Department will process your personal data in accordance with the DPA and, in the majority of circumstances; this will mean that your personal data will not be disclosed to third parties.
- 1.14. Any Freedom of Information Act queries should be directed to HMRC, using the contact details above.

Legislative timetable

- 1.15. Any consequential legislative changes, apart from changes that can take place to existing secondary legislation, will be part of the Finance Bill process, and therefore subject to the Budget process.

Impact assessment

- 1.16. An impact assessment has been produced to accompany this consultation document. Copies of which can be obtained from the HMRC website (www.hmrc.gov.uk)
- 1.17. This consultation is being conducted in accordance with the Cabinet Office Code of Practice on consultation. The consultation criteria from the Code are reproduced at Annex B.
- 1.18. For any comments or complaints regarding the consultation process, please contact the following consultation coordinator:

Duncan Calloway
Better Regulation Unit
3/37, 100 Parliament Street
London SW1A 2BQ
tel: 020 7147 2389
e-mail: Duncan.calloway1@hmrc.gsi.gov.uk

2. Issues for consultation

Current position

- 2.1. Private and pleasure craft are currently able to use gas oil (diesel) on which duty has been partially rebated. The current effective rate of duty on rebated gas oil is 7.69 pence per litre (ppl). Use of rebated gas oil is not permitted in road vehicles, and for this reason the fuel contains a combination of markers and dyes to enable misuse to be detected. For this reason it is commonly known as “red diesel”.
- 2.2. The British Marine Federation (BMF) estimate there are approximately 500,000 private pleasure boats in the UK, of which 350,000 are motor boats and therefore depend on engines for propulsion. This includes both diesel and petrol craft. A proportion of these will be residential in nature, and will also use their engines to provide energy for heat, light and other domestic purposes, and a proportion will also be available for charter or hire and thus fall into the criteria for commercial craft for part of the time.
- 2.3. There are no accurate data on the number or types of boats in the UK, either commercially or privately owned. A licensing system exists for boats on the inland waterways; however, these are operated by three main authorities which between them cover the UK inland waterways. The authorities and the areas they cover are:
 - British Waterways Authority (BWA) – covers almost all the canals and rivers such as the Severn, Trent and Yorkshire Ouse
 - Environment Agency - covers the Thames, the Medway and rivers of East Anglia with each region having its own registration and licensing system.
 - Broads authority - covers the Norfolk and Suffolk broads.
- 2.4. All the authorities require boats using the inland waterways to register and to display their registration number. The BWA enforce registration for their scheme and have compliance teams who patrol the waterways for unregistered craft. This scheme, however, is for inland waterways only and a comparable scheme for coastal craft does not appear to exist. The scheme also does not classify boats by type (cruisers, residential, etc).

Supply infrastructure

- 2.5. Typically, suppliers of fuel to the boat industry provide only one type of diesel fuel – rebated red diesel. This is used both by commercial and private pleasure craft, and in addition, depending on their location, some suppliers may also supply fuel for use in agriculture and plant machinery. It

should be noted that the removal of the derogation has no effect on commercial use: commercial craft will continue to be free to use red diesel, and commercial marine craft will continue to be eligible for full duty relief under Marine Voyages Relief.

- 2.6. Fuel sites are typically located in harbours, at marinas, on floating barges and on towpaths, and in many areas are few and far between. Supplying a second stream of fuel would involve substantial additional costs for suppliers, and would require new storage space for which planning permission is likely to become increasingly difficult. Boat owners fear that many of the suppliers with a wide customer base (commercial and agriculture) will simply opt to continue to provide only rebated fuel. There is anecdotal evidence that suppliers are already taking this decision. Smaller suppliers who cater for private pleasure craft only, faced with the not insignificant additional cashflow and security costs of supplying unrebated fuel, may just close. In either case the end effect would be to reduce the already limited number of fuel stations that service private pleasure craft. The likelihood of being able to refuel in fewer locations (particularly in remote areas) is a very real concern for boat owners, who fear that certain parts of the country (such as the Scottish highlands and islands) will, in effect, become out of bounds for pleasure craft, simply because it will be impossible to refuel other than with red diesel.
- 2.7. Costs for the installation of new tanks and pumps have been estimated to be in the region of £20,000 (£12,000 for the tank, £6,000 for pumps and £2,000 for installation).

Fuel for domestic power

- 2.8. Private pleasure boats are currently able to use rebated fuel legitimately both for propulsion and to provide heat and light. As a result of the changes required by the expiry of the derogation the use of rebated fuel will only be permitted for heating and lighting. Fuel for propulsion will need to be charged at the full rate of duty. However because space is at a premium on boats, they normally contain only one tank from which fuel is drawn for both propulsion and domestic purposes. In order to continue to use rebated fuel for domestic purposes it will be necessary for boat owners to quantify and separate this from the fuel used for propulsion, and this may require the installation of a second tank. The cost of fitting a second tank, where space is available, would vary depending on the size and type of boat; however, estimates of about £750 have been quoted for a typical inland cruiser
- 2.9. The Residential Boat Owners Association (RBOA) estimate that, for boats used as residences, over 60% of fuel taken on board is used for domestic purposes (i.e. heating and lighting). They have surveyed their members and, from those that responded, estimate that based on an average annual fuel consumption figure of 1200 litres, 720 litres a year would be for domestic purposes. There are, however, no reliable figures for the number

of residential boats in the UK and it is therefore not possible to estimate what percentage of the total boat market will be affected by this.

2.10. Under any option, consideration would need to be given to whether special arrangements should appertain in the case of residential craft (houseboats and continual cruisers).

Main stakeholders

2.11. The main groups affected by this measure have been identified as:

- Owners of private pleasure craft.
- Suppliers of fuel to the boat owners.
- HMRC.

2.12. Commercial craft are unaffected by the expiry of the derogation and can continue to use rebated fuel.

Options for change

To continue to use red diesel but pay the full rate of duty.

2.13. We have met a number of stakeholders informally who have expressed a preference for continuing to have the option of using red diesel while paying the full rate of duty. Since most rebated fuel used in boats is high in sulphur, the full rate of duty charged will be 54.68 ppl¹. This is the current rate of duty for heavy oil that is not ULSD, and represents an increase of over 600% from the current rebated fuel rate of 7.69 ppl. (ULSD has a lower duty rate of 48.35 ppl in recognition of the fact that is a less polluting fuel.)

2.14. There are two ways to take this option forward. Either

- the supplier could collect duty on sales to private pleasure craft or
- under a self regulated scheme boat owners could purchase fuel at the rebated rate and then pay the balance of duty (on a frequency to be determined).

(See options A and B below for more detail on both these options.)

2.15. The benefit of continuing to use marked fuel is that the supply infrastructure is already in place, and existing equipment and tankage can continue to be used. Fuel would continue to be available to pleasure craft throughout the

¹ Except in specified circumstances, the EPD does not allow different rates of duty to be charged on the same type of fuel. Fuel for private pleasure craft will therefore have to be charged at the road fuel rate.

UK, and there would be no restraint on pleasure cruising as a result of pleasure craft being unable to refuel. It would, however, have resource and cost implications for HMRC who would need to devise a compliance and enforcement regime, and would create compliance burdens for fuel suppliers and/ or boat owners, depending on how the scheme was administered.

2.16. Specifically, legislation would need to be introduced to tighten laws around the use of marked fuel to make it an offence to use this as road fuel irrespective of the rate of duty paid.

2.17. This scheme also has EU implications as in some member states the use of marked fuel in pleasure craft is not permitted. This, however, has always been the situation.

Option A – Supplier collects duty.

2.18. Rebated fuel is supplied only by Registered Dealers in Controlled Oils (RDCOs) who are required to maintain records of their sales. Under this option, RDCOs who chose to supply fuel to private pleasure craft would be required to identify sales to private pleasure craft, charge the higher rate of duty at the point of sale and pay the balance to HMRC when they submitted their return.

2.19. If special arrangements were to be introduced for domestic use by houseboats this could be done by the introduction of a certification scheme under which houseboat owners would need to produce the certificates before being able to purchase the fuel at the reduced rate.

2.20. This option would impose a number of burdens on fuel suppliers, boat owners and HMRC, and create a number of potential fraud opportunities which would need to be addressed.

- HMRC would need to devise and operate a return, payment, compliance and enforcement regime.
- It would place the onus on fuel suppliers to determine who was ineligible for fuel supplied at the rebated rate (and thus who should pay the full rate of duty) and to maintain records, submit returns and make payments
- It could lead to enforcement difficulties, given that there would be no obvious way of telling whether or not marked fuel in the tanks of private pleasure craft had had the full rate of duty paid on it.

2.21. The existing RDCO scheme does not require RDCOs to make payments of duty. RDCOs are required simply to record and declare to whom they have made sales of rebated fuel. The level of detail RDCOs are required to declare on their returns varies depending on the volume and nature of the

sale. For example, for domestic sales under 3500 litres, and retail or pump sales, only the total volume sold and the total number of sales is required. For higher volume sales, individual transaction details are required. This reflects the fact that the RDCO scheme's main purpose is to track the sale of large quantities of rebated fuel.

2.22. Requiring RDCOs who chose to supply fuel to private pleasure craft to collect and account for duty on retail or pump sales would increase the administration burden on them. It would also place a compliance obligation on them, as they would need to charge marked fuel at the higher rate unless they could satisfy themselves that the fuel would be put to an authorised use. In order for them to satisfy HMRC that the correct rate had been charged, they would need to keep records of their individual retail sales. The likely costs of this burden are unknown and part of the purpose of this paper is to seek information on the costs and administrative implications of this option.

2.23. Boat owners would see a significant increase in their fuel costs. The duty rate on rebated fuel is currently 7.69 ppl, compared with a duty rate of 54.68 ppl for conventional diesel (ie fuel that is not ULSD or SFD). The table below illustrates what this would mean for an average boat owner using 1200 litres of fuel a year, not making an allowance for domestic use.

Volume per annum ¹ (litres)	Duty applied at rebated rate	Duty applied at heavy oil rate	Difference
1200	£92.28	£656.16	£563.88

1. Figures taken from the RBOA survey.

2.24. However, this option would allow them to continue to use red diesel and would require no change to the existing fuel supply infrastructure. By tying this into the RDCO scheme, it would create an auditable supply chain.

2.25. Despite the additional burden this is currently our preferred option.

A1. How would this option suit your particular circumstances?

A2. What impact would this have on you/ your business?

A3. If you are a supplier of fuel would this option affect your decision to supply fuel to private and pleasure boat owners?

A4. What costs would you incur under this option? (Please be as specific as you are able to be and if possible quantify the costs.)

A5. This option suggests that it may be possible to introduce a certification scheme for houseboats that would enable owners to purchase fuel for domestic purposes at the reduced rate. Do you have any views on how this should operate? Do have alternative suggestions?

A6. We welcome your feedback on the compliance costs and admin burden estimates (contained in the impact assessment accompanying this document) for this option.

Option B – Self regulated scheme

2.26. Under this option, boat owners would continue to purchase fuel at the rebated rate, but would declare the additional duty due periodically.

2.27. The benefit of this option is that it would, in effect, maintain the status quo for suppliers, since the onus would be on boat owners to declare and account for duty.

2.28. The burden on suppliers would be less than under option A; other burdens and risks would be similar, however. There would be a significant compliance risk associated with this option as there is currently no accurate record of the number of boat owners; although the inland waterways operate licensing systems, these are administered regionally and cover inland boating only. Consequently there is no single system or record, and there would be no effective way of tracking or checking that the additional duty was being declared correctly. .

2.29. An alternative would be to create a registration system for all boats. However, the set up and development costs associated with this are likely to be significant and the resulting regime would still be highly resource intensive to operate and assure for both HMRC and the boat owners.

2.30. Given the high set up costs and significant administrative burdens on both sides we do not currently consider this to be a viable option.

B1. How would this option suit your particular circumstances?

B2. What impact would this have on you/ your business?

B3. What costs would you incur under this option? (Please be as specific as you are able to, and if possible quantify the costs.)

B4. This option suggests that the boat owner account for the duty due. However there are compliance risks to this. Do you have views on how this risk could be addressed?

B5. We welcome your feedback on the compliance costs and

administrative burden estimates (contained in the impact assessment accompanying this document) for this option

Option C - Switch to unmarked fully duty-paid ULSD

- 2.31. This option is the simplest from an administrative point of view, but is least favoured by boat owners, owing to the practical and financial issues it raises.
- 2.32. As noted in paragraph 2.6 above, this option would require the widespread establishment of a second fuel stream if it were not to restrict boat owners' freedom to cruise where they chose in the UK. The indications are this is unlikely to be achieved.
- 2.33. Under any scheme fuel suppliers would of course have the option of supplying only fully duty paid ULSD, with commercial marine users reclaiming all the duty under the Marine Voyages Relief scheme (if considered appropriate, a parallel relief could be set up for inland commercial users). However, this would result in cashflow issues for both suppliers and users, so take up of this option is likely to be low, particularly in remote areas where commercial use predominates. If a requirement for private pleasure craft to use unmarked ULSD resulted in this option being more widely taken up, it could open up opportunities for both diversion of unmarked marine fuel on which duty has been refunded, and straightforward repayment fraud.
- 2.34. If boat owners were required to purge their tanks of red diesel in preparation for taking in unmarked ULSD it is estimated that this would cost between £500 and £1000. Even then, this would be unlikely to remove all traces of the rebated marker, which could be expected to contaminate fresh fuel for some time. If tanks are not cleaned red diesel would continue to be present in a tank for significantly longer (up to 5 years has been quoted by some stakeholders). There are also the environmental implications of tank cleaning and the risk of fuel entering and polluting the waterways.
- 2.35. To complicate matters further, the Channel Islands are not affected by the Commission's decision and so will continue to supply rebated fuel for private pleasure craft, and UK boat owners will be able to fill up with rebated fuel supplied there.
- 2.36. There will therefore be instances where, although red diesel will no longer be permitted to be sold in the UK as fuel for private pleasure boats, there will continue to be legitimate reasons for its presence in the main running tanks of boats.
- 2.37. There is also some debate amongst the boat owners over the suitability of ULSD as a fuel. Some have argued that, since ULSD has less lubricity than rebated fuel, it may cause their engines to seize or break down. Other possible effects of using ULSD include seals shrinking, thus resulting in

leakage and loss of engine pressure. Opinion remains divided on this issue, but there is anecdotal evidence that manufacturers are reluctant to offer any assurances as to the suitability of ULSD as a fuel. It is worth noting, however, that in remote locations, (including the Channel Islands), red diesel needs are met by marking ULSD, so some boat owners are unknowingly already using ULSD.

2.38. In the longer term, under the terms of the Fuel Quality Directive, the sulphur content in rebated fuel will need to reduce from its current level of 2000mg/kg to 1000 mg/kg by 31 December 2007 and it is likely that these levels will be reduced further with the aim of ultimately achieving a 'sulphur free' level in the future.

2.39. The current duty rate for ULSD is 48.35 ppl and represents an increase of 40.66ppl or, using an annual fuel consumption figure of 1200, taken from the table at 2.23 above, an annual increase of £487.80.

2.40. There would be some environmental advantage to switching to ULSD in that this is a cleaner fuel and there would be small reductions in sulphur dioxide and carbon emissions; however, the boat industry forms but a small part of the total usage of the total oils market and any savings made are likely to be negligible when considered overall.

2.41. In light of the above this is not currently a favoured option.

C1. How does this option suit your particular circumstances?

C2. What impact would this have on you/ your business?

C3. If you are a fuel supplier, would this option affect your decision to supply fuel to private pleasure boats?

C4. What costs would you incur under this option? (Please be as specific as you are able to and if possible quantify the costs.)

C5. We welcome your feedback on the compliance costs and admin burden estimates (contained in the impact assessment accompanying this document) for this option.

Impact on revenue

2.42. We estimate that the revenue gain from the expiry of the boat derogation is in the area of £10 to £15m a year. It follows that this is the maximum additional revenue at risk from private boating if, for example, boat owners were allowed to continue using red diesel but misused the scheme by (depending on the option adopted) misleading RDCO suppliers as to nature of their boat (ie commercial/ domestic), failing to submit returns or submitting false repayment claims. HMRC's enforcement effort must be proportionate to this risk. Taken in the context of a total yield of £24bn

(05/06) from oils, the private pleasure craft industry would account for 0.06% of the total revenue.

Compliance costs and Administrative Burden

2.43. All three options impose additional costs on both businesses and pleasure craft users. Those costs that are faced by businesses may have an impact on the administrative burden baseline. HMRC will also face additional costs in ensuring compliance with each option. Estimates of this for each option are included in the impact assessment accompanying this document and we welcome your feedback on the estimate of these costs.

Competition Impact

2.44. The loss of the derogation will increase the cost of fuel for pleasure boat use. This could reduce the volume of sales and the profit margin for suppliers initially, which could lead to a reduction in the number of suppliers.

Annexes

Annex A – Questionnaire

About you

Are you a private pleasure or commercial boat owner?

For private and pleasure users please provide information on your boating habits. In particular, we would be interested in:

- how often do you use your boat,
- do you use the inland waterways or are you a marine boater,
- what fuel do you currently use (petrol/ ULSD/ rebated/ other please specify)
- how much fuel do you use per annum,
- where do you refuel – marinas, towpaths etc.

Are you a fuel supplier who makes sales to boats?

Please provide information on the type of supplies that you make and who forms your customer base. In particular we would be interested in:

- how many streams of fuel do you currently supply
- whom you supply to (retail/ wholesale)?
- a breakdown of supplies (litres per annum of different fuel types) to commercial boat owners and a similar breakdown for private boat owners.
- can you distinguish between the two types of users; if so, how?

Options for change

Please provide any comments you may have on the options set out in the consultation document.

Option A – Supplier collects duty

A1. How would this option suit your particular circumstances?

A2. What impact would this have on you/ your business?

A3. If you are a supplier of fuel would this option affect your decision to supply fuel to private and pleasure boat owners?

A4. What costs would you incur under this option? (Please be as specific as you are able to be and if possible quantify the costs.)

A5. This option suggests that it may be possible to introduce a certification scheme for houseboats that would enable owners to purchase fuel at the reduced rate. Do you have any views on how this should operate? Do you have alternative suggestions?

A6. We welcome your feedback on the compliance costs and admin burden estimates (contained in the impact assessment accompanying this document) for this option.

Option B – Self regulated scheme

B1. How would this option suit your particular circumstances?

B2. What impact would this have on you/ your business?

B3. What costs would you incur under this option? (Please be as specific as you are able to, and if possible quantify the costs.)

B4. This option suggests that the boat owner account for the duty due. However there are compliance risks to this. Do you have views on how this risk could be addressed?

B5. We welcome your feedback on the compliance costs and admin burden estimates (contained in the impact assessment accompanying this document) for this option.

Option C – Switch to using unmarked ULSD

C1. How would this option suit your particular circumstances?

C2. What impact would this have on you/ your business?

C3. If you are a fuel supplier, would this option affect your decision to supply fuel to private pleasure boats?

C4. What costs would you incur under this option? (Please be as specific as you are able to and if possible quantify the costs.)

C5. We welcome your feedback on the compliance costs and admin burden estimates (contained in the impact assessment accompanying this document) for this option.

Annex B – Consultation Criteria

The consultation criteria are listed in the Cabinet Office Code of Practice. If you wish to access the full version of the Code, you can obtain it at:

www.cabinet-office.gov.uk/regulation/Consultation/Code.htm

The regulatory implications, which will be informed by responses to this consultation, will be an important factor in any decision. If Ministers decide to proceed with any changes, a full regulatory impact assessment will be published.

THE CONSULTATION CRITERIA

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about who may be affected, what questions are being asked, and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

If you feel that the consultation does not satisfy these criteria, or if you have any complaints about the process, please contact –

Duncan Calloway
Better Regulation Unit
020 7147 2389 or duncan.calloway1@hmrc.gsi.gov.uk