Creating a new global market for emissions units: preliminary reflections on tax treaty issues

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Linking of Emissions Trading Systems

› Update on Australia’s Carbon Pricing Mechanism
› Newest developments: linking to the EU ETS
› Preliminary reflections on tax treaty issues in light of OECD revised public discussion draft:
  “Tax Treaty Issues Related to Emissions Permits/Credits”
  (released 19 October 2012)
THE CARBON PRICE

Image from cleanenergyfuture.gov.au
Update on Carbon Pricing in Australia

First Phase Commenced on 1 July 2012

› Fixed price period (until 2015): $23 per tonne/unit
› Liable entities public information database: 351 entities as at 11 Jan 2013
› Industry assistance
  - Jobs & Competitiveness Program – 2 rounds of allocations so far
  - Coal-fired generation assistance – allocations to come (1.9.13)
› Carbon Farming Initiative – first allocations 30 Nov (348k now in total): all landfill gas projects to date receiving allocations
Image from game-and-puzzle-treasury.com
Linking Agreement

Cross-scheme unit flows: CPM and EU ETS

› Phase 1: from 1 July 2015 (flexible price period) – inward flows
  - Use of EU ETS units to meet CPM liabilities
  - Scrapping of the price floor
  - New limit to use of int’l units: 12.5% use of credits from CDM (CERs); 50% of liabilities can be met with international allowances

› Phase 2: from no later than 1 July 2018 – unlimited linking (mutual recognition of units)
  - Details to be negotiated
Features of Div 420 addressing international issues

› Deemed Aus source: connection by way of maintenance of Registry account enough

› Importing emissions units – direct transfer to Aus Registry account (s 420-21)
  - Deemed sale/repurchase for cost if revenue asset or trading stock
  - Deemed sale/repurchase for market value if capital asset
  - Transfers under linking agreement?

› Exporting emissions units: deemed sale/repurchase for market value

› Changing residency (ss 420-22 and 420-41)
TAX TREATIES

Image from gowarsaw.eu
OECD Discussion Draft

› Initial draft in May 2011 focussed on permit trading and compliance units

› Revised discussion draft in October 2012 expanded to address the issuance of permits as well as trading in CERs and ERUs

› Comments closed 15 January 2013; review by Committee on Fiscal Affairs scheduled for February

› Recommends some additions to the Commentary to clarify the tax treaty treatment of these transactions
Comments on domestic tax treatment

› As noted in OECD draft, most domestic tax laws do not have provisions specific to emissions permits but nominates NZ as the exception

› Australian now has comprehensive domestic tax rules with respect to units held on the Australian Registry (Div 420)
  - But units held outside Registry (such as EU ETS units on initial purchase) still subject to general rules

› In many jurisdictions, accounting treatment will lead tax treatment but accounting treatment is not settled – several major issues are still the subject of debate at IASB
Issuance of permits

› OECD discussion draft: most practical option to recognise income from free allocation on alienation (nil cost base) and no indication that any State recognises income on issue

› However, Australian approach to assess value of free allocations in year of issue (inclusion in closing balance)
   - Jobs & Competitiveness Program – subject to no disadvantage rule
   - Coal-fired electricity generation assistance scheme
   - Carbon Farming Initiative

› Timing issue – likelihood that this will arise??
Tax Treaty Issues

Characterisation of income/gain from trading activities

› Includes income from free allocations as well as gains from trading in units

› Article 7 business profits in most cases

› Article 13 capital gains also possible

› Tension between compliance and trading activities
  - Australian rules deem all profits on revenue account regardless of purpose in holding

› Any practical consequence?? May be timing issue only due to differences in domestic rules
Special issues re offset units

› Article 6 income from immovable property
  - Units themselves not likely to be considered immovable property
  - Income from real property?
  - Profits of an enterprise from agriculture and forestry?

› CFI link to land-based activities not unlike international offsets considered in the discussion draft (CERs and ERUs)

› CFI projects more likely to involve non-residents recipients of free allocations
Looking forward to a developing international market

› Developing a deep market for Australian carbon units once move to variable pricing in 2015
  - Potential for international traders to participate in Aus market and joint Aus-EU ETS market from 2018
  - Several regional markets are being set up with opportunities for additional linking agreements

› Agreement on accounting treatment is needed

› Likely development of domestic tax rules or revenue practice for carbon units as entities move to net liability positions