



**CPRS – An overview of the
taxation treatments for business**
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Outline

- CPRS – The proposed tax rules
- Taxation of Free Permits
- Tax valuation issues
- Interaction with other income tax rules
 - Overview
 - Capex
 - Non-deductible expenses
- GST & Stamp Duty
- Carbon Sink Forest deduction
- Excise
- R&D
- Panel discussion and questions

Objective of the Tax Scheme

Tax should not compromise objectives of

- meeting Australia's emissions reduction targets
- contributing to the development of an effective global response to climate change

Broad principles of the CPRS tax scheme are

- simplicity, efficiency and equity
- discrete income tax laws to accompany CPRS legislation
- general GST laws to accompany CPRS legislation
- permits on revenue account

Fundamental decision for business are

- Buy permits
- Reduce emissions; and/or
- Sequestration or destruction of synthetic emissions

Emission unit dealings – income tax issues

Activity	Proposed tax treatment
Purchase of unit	Deductible in year of purchase, unless “banked”
Importation of unit (international emissions unit)	General income tax provisions apply prior to registration of unit on National Registry Registration on National Registry results in a deemed sale and purchase of the unit at market value at the registration time (CGT event K1 will apply for units held on capital account and a capital gain or capital loss may arise on registration)
Banking of unit	“Rolling balance method” of tax accounting applies: (i) Closing tax value* of unit included in assessable income (ii) Opening tax value* of unit is an allowable deduction
Surrender of unit	No income tax implications if surrender occurs in the year of purchase Deductible in year surrendered if previously banked – deduction equal to tax value
Sale of unit	Proceeds included in assessable income in year of sale (deemed market value rules apply for related party dealings)
Export of unit (international emission unit)	Similar to importation and a deemed sale and purchase event occurs at market value as at the time of de-registration (CGT event K1 may apply for units held on capital account)

* Tax value equals cost or market value subject to the taxpayers election – transitional rules apply over the transitional period

Administratively Allocated (“Free”) emission units

Income tax issues

Activity	Proposed tax treatment	
	Emissions intensive trade exposed	Coal Fired Power
Unit allocation	Assessable if banked – “no disadvantage” deferral mechanism modifies the rolling balance method	Assessable if banked
Banking of unit	<p>“Rolling balance method” of tax accounting applies:</p> <ul style="list-style-type: none"> (i) Closing tax value of unit included in assessable income – <i>tax value equals zero in year 1</i> (ii) Opening tax value of unit is an allowable deduction – <i>opening tax value equals zero in year 2</i> (iii) <i>Closing tax value in year 2 equals deemed market value as at the allocation time</i> 	<p>“Rolling balance method” of tax accounting applies:</p> <ul style="list-style-type: none"> (i) Closing tax value of unit included in assessable income - <i>tax value equals deemed market value as at allocation time in year 1</i> (ii) Opening tax value of unit is an allowable deduction – <i>opening tax value equals deemed market value as at allocation time in year 1</i>
Surrender of unit (FIFO applies)	<p>No further income tax implications if surrender occurs in year 1 or year 2</p> <p>Deductible in year surrendered if banked in year 1 and surrendered in year 3 or thereafter</p>	<p>No further income tax implications if surrender occurs in year 1</p> <p>Deductible in year surrendered if previously banked and surrendered in year 2 or thereafter</p>
Sale of unit (FIFO applies)	Proceeds included in assessable income in year of sale (deemed market value rules apply for related party dealings)	As for EITEs

Valuation issues

Activity	Valuation
Purchase of unit (unrelated parties)	Cost equals purchase price – ordinary meaning may include transaction costs
Purchase of unit (related parties)	Cost equals market value (plus transaction costs?)
Importation of unit (international emissions unit)	Market value as at registration time (plus transaction costs?)
Free unit - EITEs	<ul style="list-style-type: none"> (i) On registration – Nil (no disadvantage rule applies – see item (iv) below) (ii) Closing tax value in year 1 – Nil (no disadvantage rule applies) (iii) Opening tax value in year 2 – Nil (no disadvantage rule applies) (iv) Closing value in year 2 – Market value as at the initial registration time (transaction costs?)
Free unit – non EITEs	Cost equals market value just after registration as holder of the unit (plus transaction costs?)
Banking of unit	<p>“Rolling balance method” of tax accounting applies:</p> <ul style="list-style-type: none"> (i) Closing tax value - cost or market value (ii) Opening tax value equals closing tax value (that was included in assessable income in the prior year) <p>An irrevocable tax valuation election to be made by the taxpayer at the end of the 1st income tax year where it holds the relevant unit</p> <p>Taxpayer may change a valuation election once during a transitional period ending with the 2014-15 income year</p> <p>Special rules apply for EITEs</p>

Valuation issues

Activity	Valuation
Surrender of unit – taxable purpose	Nil
Surrender of unit – non-taxable purpose	Nil Deductions are denied and claw back rules apply for any acquisition costs previously claimed as allowable deductions
Sale of unit – unrelated party	Proceeds equal any amount the entity is entitled to receive on disposal
Sale of unit – related party	Proceeds equal market value as at disposal time (transfer pricing rules continue to apply)
Exportation of unit (international emission unit)	Market value as at de-registration time

“Free” units – EITE example

Dates	Events	Tax implications
1 July 2011	Nil balance of units on hand at the start of the income tax year	Nil deduction for opening tax value of units
Aug 2011	EITE receives 1m free units (Market value = \$21m)	No assessable income on receipt of units No deduction for costs incurred in relation to the allocation of “free” units
Oct 2011	EITE sells 400,000 units @ \$22 (Market value = \$8.8m)	Assessable income includes proceeds on sale of \$8.8m
June 2012	EITE surrenders 400,000 units	Nil – no allowable deduction based on FIFO
30 June 2012	Closing balance of EITEs – 200,000 units (MV \$22 p/u = \$4.4m)	Nil – Closing tax value of units on hand in year 1 (opening tax value in year 2 is also nil)
30 June 2013 2012	Closing balance of EITEs – 200,000 units (MV \$22 p/u = \$4.4m)	Assessable income includes \$4.2m Closing tax value of units on hand in year 2 based on MV as at the date of issue – i.e. \$21 p/u in Aug 2011)
July 2013	EITE sells remaining 200,000 @ \$25 (Market value = \$5m)	Assessable income includes \$5m Allowable deductions includes \$4.2m opening tax value of units

Interaction with other income tax rules

Overview

- **Anti-overlap rules apply**
 - Division 420 takes priority over
 - i. Ordinary income and other statutory income
 - ii. Other allowable deductions
 - iii. Trading stock provisions
 - iv. Capital gains tax provisions
 - v. TOFA rules
- **TOFA will not apply to emissions units – but will apply to derivatives**
- **Tax consolidation**
 - units are reset cost base assets (revenue assets)
 - joining and leaving events require close examination
- **Foreign residents**
 - Dealings in eligible emissions units registered on the National Registry have an Australian source
 - Close examination of double tax agreements is required
- **PAYG instalment income includes all assessable income derived from the sale of units**
- **Gifts of units to deductible gift recipients are deductible**

Interaction with other income tax rules

Capex

- **Soft capex**
 - Advisory services related to
 - i. CPRS transitional issues
 - ii. Economic modelling of impacts
 - iii. Feasibility assessments of responses
 - iv. Operational reviews and enhancements
 - v. Review of reporting and analysis capabilities
- **Hard capex**
 - Acquisition of tangible/intangible assets
 - i. Capital allowances
 - ii. CGT assets
 - iii. Ownership rights and quasi ownership rights related to sequestration projects (e.g. land v forest)
 - iv. Valuation and apportionment of proceeds from sale/acquisition costs
 - v. Unit price volatility and deferred and/or contingent consideration
- **Capital v revenue distinctions**
- **Capital allowances**
- **Cost base for CGT assets v Black hole expenditure**

Interaction with other income tax rules

Non-deductible expenses

- **No deduction under Division 420 where a unit is issued in accordance with:**
 - i. The EITEs assistance program
 - ii. The coal fired electricity generation assistance program
 - iii. Carbon sequestration by reforestation program
(limited deductions available)
 - iv. Destruction of synthetic greenhouse gases program
(limited deductions available)

Deductions may be available in respect of costs incurred in relation to the receipt of units under these programs under the general income tax provisions or Division 40 “black hole” rules

- **No deduction if surrender for non-commercial purposes**
 - i. Based on section 8-1 (e.g. no deduction for voluntarily offset for private purpose)
 - ii. voluntary expenditure directed at commercial marketing and promotional is a valid commercial purpose

Interaction with other income tax rules

Non-deductible expenses

- **Other**

- Nexus with derivation of assessable income required to establish deduction
- Forestry sequestration and destroying synthetic greenhouse gases
 - i. Expenditure incurred in these activities is not deductible under Division 420
 - ii. General allowable deduction and capital allowance rules continue to apply
- Penalties apply for failing to surrender sufficient permits
 - i. Penalty component – non-deductible
 - ii. “Make good” component (e.g. acquisition and surrender of additional units) - deductible

Indirect Taxes

- **GST**

- Eligible emissions units and international emissions units are personal property rights and not real property
- General GST rules will apply
 - i. Sale / Purchase within Australia is subject to GST
 - ii. Import – no GST
 - iii. Export – GST free
 - iv. No GST on free units, or surrender of permits
 - v. Financial derivatives over emissions units may be input taxed

- **Stamp Duty**

- Commonwealth government is requesting that no stamp duty be levied by States

Carbon Sink Forest Deduction

- “Free” emissions units may be issued in relation to eligible reforestation projects
 - Requires submission of an application and the issue of a certificate of reforestation
 - Similar tax outcomes to “free” emissions units issued to coal fired power generators
- Principal purpose is carbon sequestration by the trees
- Rules to qualify very prescriptive
 - Environmental & Natural Forest Management guidelines
- Deduct expenditure in establishing trees
 - 2007/08 to 2011/12 years – 100% deduction
 - 2012/13 year onwards – 7% deduction
 - Notification requirements must be satisfied
 - (i) taxpayer to give the Commissioner a statement (in the approved form)
 - (ii) Statement must include all necessary information
 - (iii) The statement must be given to the Commissioner no later than the earlier of:
 - a) the lodgement of the taxpayer's income tax return; or
 - b) 5 months after the end of the income year
- Not available to passive investors, managed investment schemes or managed forestry schemes

Fuel excise adjustments

- **Reduction in private motorist fuel excise**
 - reviewed and adjusted every six months for 3 years ended 1 July 2013
 - final fuel excise to be set on 1 July 2013
- **Agriculture, fishing and heavy on-road transport**
 - CPRS fuel credit scheme to equal fuel reduction in excise
 - Different credit arrangements apply for LPG, LNG CNG and petrol and diesel
 - Transitional arrangements for specific industries:
 - (i) Agriculture and fishing – 3 year transition
 - (ii) Heavy on-road transport – 1 year transition
 - CPRS fuel credits to be reviewed on expiry of transitional periods

R&D Tax Concession

- Entitlement program
- Introduced in July 1985 to encourage business expenditure on R&D in Australia
- Federal Government initiative to:
 - Promote R&D in Australian Industry; and
 - Improve Australia's competitiveness worldwide
- Administered jointly by the ATO and Innovation Australia (AusIndustry)
- A 'base rate' deduction allowance of up to 125% of expenditure incurred on eligible R&D activities
- Premium rate of 175% for 'additional' R&D, based on a 3 year average

How *Climate Change friendly* is the tax system?

- **Deductibility of environmental protection activities?**
- **Carbon sink forestry deduction – not quite law**
- **FBT on abating employee motor vehicle emissions?**
- **R&D tax concessions – strengthen for low emissions technologies**
- **Grants (eg Re-tooling for Climate Change)**
- **Tax incentives to kick start change:**
 - Accelerated tax depreciation?
 - Targeted investment allowance?

Clean energy – tax issues and incentives

- **Windfarms – Australia’s “safe harbour” write off over 20 years compared to France’s 1 year write off**
- **Geothermal “exploration” – Does this qualify for the 100% write off available to minerals exploration?**
- **Potential stamp duty exposures on windfarm transfers**
- **Renewable Energy Fund (REF) \$500m**

Panel discussion and questions
