

Level 2
95 Pitt Street Sydney, NSW 2000
Telephone 02 8223 0000
Facsimile 02 8223 0077
Email tia@taxinstitute.com.au
Website www.taxinstitute.com.au
ABN 45 008 392 372



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The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

Email economics.sen@aph.gov.au

Dear Sir

Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009

The Taxation Institute of Australia (Taxation Institute) in response to your letter dated 27 May 2009 is pleased to provide the following comments in respect of Good and Services Tax (**GST**) issues arising from the proposed amendments contained in Schedule 2 of the *Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009*.

The GST is proposed to be applied to trading in emissions units. This approach is based upon the mistaken belief that an emissions unit is akin to any other business input (eg a piece of steel) and that consistency of treatment with other inputs is more important than any compliance costs imposed on consumers. The Government also believes that the reduction in compliance costs to the community in respect of the trading of emission permits "... would undermine the objective of meeting Australia's emissions reductions in a cost-effective way by providing a preferential GST treatment for emissions units relative to pursuing other ways of reducing emissions". However, loading the cost of emissions permits with inefficient and distortionary compliance costs only reduces the efficiency of the Carbon Pollution Reduction Scheme (**CPRS**). It should be the market price of the units that encourages other ways of reducing emissions not compliance costs.

The problem is that an emissions unit will not be traded like a piece of steel, where an order is sent to a supplier, who some days later, delivers the steel. Rather, due to the design of the scheme which discourages holding of emission units, the trades will occur in high volumes (with in excess of 460 million permits available to be traded), electronically, in split seconds by traders in a market not dissimilar to the stock exchange or the futures market. Currently, those finance trading markets do not apply GST to dealings in marketable securities such as shares and options.

Unnecessary development costs

As a result of applying GST to emissions units, business will need to incur substantial costs in developing systems that are able to capture the GST in an electronic trading environment. Not only will this be complex, further exceptions in the GST law will need to be created to provide for modified tax invoices, identification rules for traders, etc. It is these high compliance costs which convinced the New Zealand Government to treat emission permits as GST free despite having GST which applies to virtually all supplies of goods and services.

In a mature system where open emissions trading market exists, foreign entry will result in an increase in the level of GST free trading due to the export of permits, and compliance will become more complicated because systems will need to be set to differentiate between taxable and GST free trading. The imposition compliance costs to set up a system in circumstances where there is a strong chance of abandonment when the Australian market becomes open, is a waste of Australia's scarce resources which give rise to nil revenue. The system needs to be designed as if the mature system were in place. GST free treatment will remove the compliance cost in creating systems to collect GST in a huge volume market, and reduce the complexity of the GST rules by removing the need for consequential amendments to create special case rules to deal with the complexity of the market.

Reduction in Complexity

The following table illustrates that under the current proposal there is, despite assertions to the contrary, no consistency with the treatment of emission permits as some transactions are taxable and others are not.

Circumstance	GST Treatment
Buying or selling a unit	Taxable Supply
Supply of free unit	No GST (no consideration)
Import or Export of units	No GST (out of scope)
Government Cash Grant	No GST (no supply)
Surrender of a unit	No GST (no consideration)
Payment of a penalty	No GST

Thus, there is an overall increase in complexity, administration and tracking costs by not making all transactions GST Free. Distinguishing between the different types of transactions increases the likelihood of processing errors, rework, penalties, etc for no added value. As a real example, the cost to correct a simple GST rounding error on fractions of one cent, can, for an energy supplier, amount to over \$500,000.

Working capital costs

Another concern is that the treatment of units as being taxable will result in a permanent increase in the working capital requirements of companies (over \$1 billion once the scheme becomes fully operational) to fund the GST between the time of purchase and the BAS lodgement time (somewhere between 21 and 52 days afterwards) when the GST input credit is allowed. Most businesses will be forced to recoup the high funding cost by higher prices to consumers. Others will have to absorb the cost as they may not be able to pass on the cost, further exacerbating the financial impact.

Trapped GST costs

The proposed legislation will result in input taxation of the CPRS based derivatives on the basis of simplicity and consistency. Given that the CPRS was preferred as the most efficient mechanism for delivering carbon reduction by the creation of deep secondary markets of units and the associated derivative products, the input taxation of CPRS derivatives operates to undermine that strategy. The input taxation of the derivatives (in the estimated \$115 billion per annum secondary market) will give rise to large amounts of trapped GST and businesses will be forced to recoup this trapped GST by higher prices to consumers or to their financial detriment. The input taxation of this newly created class of derivatives seems to run contrary to the Government's undertaking not to increase the scope of the GST.

In addition, where units are "imported" and used to underpin dealings in derivatives, the above complexity will be added to by the need to "reverse charge" GST on the importation. This is

because of specific rules which require an importer of intangibles from overseas to pay GST if they use the thing they import to trade in derivatives such as hedges.

Summary

The proposal to treat trading in emissions units as taxable for GST and the input taxation of dealings in certain derivatives creates costs to industry which are expected to be passed on to consumers. It is considered that there is a better model for the imposition of GST which will reduce the end costs to consumers of the CPRS. That model is GST free treatment for all dealings in emissions units and derivatives based on emissions units.

The Taxation Institute would be happy to appear before the Senate Committee to discuss these issues further. If you require any further information or assistance in respect of our submission, please contact Joan Roberts on 03 9611 0178 or the Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis, on 02 8223 0011.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Joan Roberts', with a stylized flourish at the end.

Joan Roberts
President