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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Offsets and Verification Team
Renewables, Offsets and COAG Branch
Department of Climate Change
GPO Box 854
CANBERRA ACT 2601

Email offset@climatechange.gov.au

Dear Sir

National Carbon Offset Standard

The Taxation Institute of Australia (Taxation Institute) is pleased to provide comments on the *National Carbon Offset Standard Discussion Paper* ('Standard Discussion Paper') released for public comment in December 2008.

By way of background the Taxation Institute is a national body of over 15,000 members, with a focus solely on taxation. Our members include tax agents, accountants, lawyers and members of the judiciary with an interest in taxation, in all its various forms, as well as officers of the Australian Taxation Office ('ATO'), Treasury and State Revenue Offices.

In the past the Taxation Institute has worked closely in consultation with the Parliament of Australia (through Ministers and Parliamentary Committees), the Treasury and the ATO (as well their international counterparts), regulatory review agencies (including the Board of Taxation, Inspector General of Taxation, the Australian National Audit Office and the Tax Agents' Boards) and State and Territory Revenue authorities. We also have strong and constructive relationships with other tax professional, industry representative, and academic and research bodies, both in Australia and overseas.

The Taxation Institute is concerned that the income tax rules applying to entities covered by CPRS must be consistent with the rules applying in the voluntary carbon market. A lack of consistency in taxation treatment may lead to a distortion in climate change adaptation and mitigation decision-making by entities, and hence create inequity and inefficiency in the Australian economy.

The Government has indicated in the White Paper for CPRS released on 15 December 2008 that an income tax deduction will be allowed for the acquisition by business of Australian Emissions Units (AEUs). Specific provision will be made in a new division to be inserted into the *Income Tax Assessment Act 1997* (Cth) ("the Tax Act") to put the matter beyond doubt.

It is by no means clear that an identical treatment will apply to acquisition of voluntary carbon credits (VERs) under existing law.

Section 8-1 of the Tax Act provides:

> (1) You can ***deduct*** from your assessable income any loss or outgoing to the extent that:
>
> (a) it is incurred in gaining or producing your assessable income; or

(b) it is necessarily incurred in carrying on a * business for the purpose of gaining or producing your assessable income.

There is a technical risk, because there is a strict requirement in the Standard for "voluntary action" in offset projects as a basis for generating offset credits or claims, that such requirement will conflict with the income tax test for deductibility and hence take the acquisition of VERs outside s 8-1.

Yet, the department recognises in the Standard Discussion Paper:

> "Businesses buy carbon credits to offset particular products and services and to meet corporate commitments to social responsibility, including carbon neutrality. They may also purchase credits to offer carbon offsets to individual customers bundled with other goods or as an incentive to purchase goods from a specific supplier" (page 3).

It is noted in the paper that business accounts for almost 80 per cent of purchasers in the voluntary market (29 per cent are businesses that purchase for investment or resale and 50 per cent are businesses that are final buyers), hence resolving any income tax uncertainty is a pressing issue. Any adverse impact arising from the tax deductibility of acquisition of VERs or residual risk perceived by business about non-recognition of their income producing activity will adversely impact the voluntary market, and skew investment away from abatement outside of the CPRS.

Accordingly, the Taxation Institute suggests that an approach to the resolution of the income tax uncertainty is to enshrine specific rules into the Tax Act in a manner similar to the specific rules proposed to be adopted for CPRS. Specific provision should be made in the Tax Law providing for tax deductibility of offset purchases, and to specify that activity undertaken to generate offset projects should be treated as being for income producing purposes.

Empirical evidence cited by the Department demonstrates that the relevant nexus for deductibility exists:

> "When participating in the voluntary carbon market entities are motivated by a number of factors, but rank corporate responsibility and public relations/branding as most important. Across a variety of purchasing criteria entities regard additionally of offsets, the demonstrable ability to reduce emissions beyond levels that would be straightforward to carry out, clear to understand and otherwise have occurred, as one of the most important. Thus the integrity of carbon offsets is important to the reputation and public positioning of the purchasing entity. … An increasing number of entities have been purchasing offsets with the aim of making their product or service 'carbon neutral." (Page 5)

The Taxation Institute considers that the tax law should not discriminate between CPRS and non-CPRS activity. A specific amendment to the Tax Law as suggested would put this concern beyond doubt.

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

Joan Roberts
President