

Companies must pay for pollution

The need to address climate change and hold off global warming has turned gas emissions into a tradable commodity

ROBERT GAD
and VARUSHA FAKIR
Edward Nathan Sonnenbergs

THE Kyoto Protocol which came into effect in February 2005 is an international treaty which aims to achieve a certain level of reduction of greenhouse gas emissions by 2012 in the hope of delaying the effects of global warming.

The protocol allows for the trading of emission quotas among industrialised countries which have been allocated to them by the Clean Development Mechanism (CDM) executive board, a body formed under the protocol. The credits are awarded to companies for reducing carbon emissions and can be sold in the open market to other companies to enable them to offset their emissions.

Emission trading enables those who failed to adhere to their targets under the protocol to purchase emis-

sion credits, commonly from developing countries, who had an excess of unutilised credits available to them.

The trading of carbon credits is facilitated through the medium of certified emissions reductions which take the form of certificates.

Certified emissions reductions are awarded to businesses in countries which are signatories of the protocol, depending on their level of reduced greenhouse gas emissions annually.

The introduction of mechanisms to curb the output of carbon emissions has arisen from the need to address climate change and global warming. The fixed rate of allowable emissions and the resultant trade in emissions serves to benefit the environment in that companies have to pay for the right to pollute, ensuring a certain predictable environmental outcome.

Emissions trading has also proved considerably appealing to private industries in that by decreasing emis-



sions, companies stand to profit by selling their excess greenhouse gas allowances. This benefits the environment as creating such a market for pollution could potentially drive emissions reductions below expected targets.

The fixed quantity of permitted emissions under the protocol has led to a system of buying and selling certified emissions reductions, effectively turn-

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ing the right to emit certain gases into a tradable commodity. Certified emissions reductions earned and awarded to a party by the CDM executive board are referred to as "primary" certified emissions reductions, while certified emissions reductions bought from such parties are referred to as "secondary" certified emissions reductions.

In the 2009-2010 budget review, Finance Minister Trevor Manuel proposed the introduction of CDM projects in SA, including the taxation of carbon emissions and the use of certified emissions reductions as an incentive for cleaner production and energy efficiency. Manuel proposed a favourable tax treatment for the income arising from the sale of primary certified emissions reductions. The proceeds from the sale of secondary certified emissions reductions would be taxed as sales of "trading stock" — that is, at the normal income tax rate.

There are a plethora of tax issues associated with certified emissions reductions which would require consideration. These issues were not mentioned in the budget review, but include rules for determining the tax cost of primary credits which are disposed of; whether the cost to a purchaser is of a capital or revenue nature where the credits are not acquired for resale; the cross border tax implications (as most transactions would be international); the value-added tax (VAT) implications for buyers and sellers; whether the acquisition of a credit on issue is a taxable event for the acquirer and so on.

As mentioned by the minister, the uncertainty relating to the tax treatment of certified emissions reductions both in SA and other foreign jurisdictions has resulted in the delayed adoption of such an incentive-driven scheme. Despite such uncertainty, however, the proposals relating to carbon credits promise to introduce a new taxation regime that could potentially be adapted to more effectively introduce incentives into other industries.