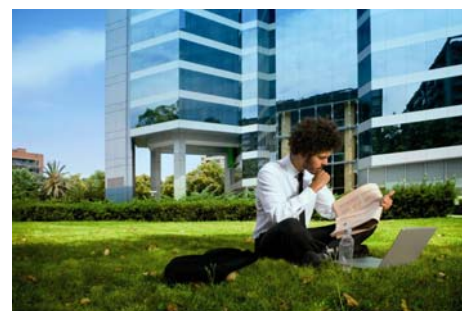


Green Paper outlines Carbon Pollution Reduction Scheme

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Introduction

The Minister for Climate Change and Water, Penny Wong, on Wednesday 16 July released the Federal Government's Green Paper on the design of a national emissions trading scheme. The paper offered more clarity than many expected about what the government has named the *Carbon Pollution Reduction Scheme* (CPRS), especially for those Australian industries operating in global markets which are potentially disadvantaged by such a scheme. These industries are referred to as emissions-intensive trade-exposed (EITE) industries.

Emissions thresholds for affected businesses were spelt out for the first time. The scheme will be subject to a number of constraints, some temporary, which will create a transitional stage to ease acceptance by businesses. Such constraints include the operation of a price cap; restrictions on the recognition of international offsets; and compensation for EITEs and a new category of affected businesses the paper calls "strongly affected industries" (SAIs).

Although the initial response from business was tentative acceptance, concern still remains that higher energy costs resulting from the imposition of a carbon price may cut earnings for the resource companies currently driving Australia's growth. Industry bodies have criticised the fact that feedback on the Green Paper must be submitted by 10 September 2008, a month before Treasury's economic modelling on the costs of various emissions reductions scenarios is released. Meanwhile, carbon trading experts welcomed the scheme, claiming it offered broad coverage of the economy, a significant level of credit auctioning and a workable model for proposed cap-and-trade schemes across Asia, such as those being planned in South Korea and Japan.

According to the Green Paper, around 1,000 businesses will be covered by the scheme, which will be one of the most broad-based in the world. Also, six Kyoto Protocol greenhouse gas emissions will be covered from commencement. From the start stationary energy, transport, fugitive emissions, industrial processes and waste will be included on a compulsory basis, plus forestry on an opt-in basis. A decision will be made in 2013 on whether to include agriculture, with its likely inclusion at the earliest by 2015.

The depth of detail in the Green Paper, and the fact it was presented by the Prime Minister, the Treasurer and the Climate Change Minister, indicate that the Federal Government sees this scheme as a priority project and a central pillar of Australia's shift to a carbon-constrained future.

Five key questions CEOs might ask

Is my business impacted?

All Australian based businesses will be impacted directly or indirectly. Those which meet specified emissions thresholds and are part of a covered sector will be directly affected. Direct obligations will be placed on facilities with large emissions and for fuel combustion emissions, obligations will be placed on upstream fuel suppliers. Thresholds will vary for certain sectors such as transport, forestry and waste. Other businesses will be affected indirectly through cost (increased energy cost), risk (potential supply chain disruption as their energy suppliers are affected) and opportunities (providing low-carbon services, funding for low emissions technology, for example).

What are the financial implications if I am directly impacted?

There will be costs from permit purchase, achieving emission reduction, compliance (eg management time, systems, consultant spend) and assurance. There will be the potential for revenue generation from permit selling, research and development funding.

How quickly will this happen?

The start of the first compliance year is 1 July 2010, but there will be transitional arrangements to ease some sectors into the scheme, such as fuel, coal-fired electricity generation and agriculture. The timeframe is such that firms need to start working towards participation immediately. (The paper maintained the emissions reporting requirements for companies caught by the *National Greenhouse Gas and Energy Reporting Act 2007* (NGER), which started on 1 July 2008, and proposes to build on those requirements.)

Can I get any assistance?

The Green Paper outlines a number of funding systems to help affected businesses. There will be funding through two new funds, the Climate Change Action Fund (CCAF) and the Electricity Sector Adjustment Scheme (ESAS); tax incentives (fuel, R&D); transitional arrangements; compensation for EITE businesses (free permits) and assistance for Strongly Affected Industries such as coal-fired electricity generators.

What don't we know yet?

Despite the unexpected level of detail in the Paper, much is still unspecified. This includes emission target trajectories, penalties for non-compliance and complementary measures for uncovered industries.

While the focus appears to be upon providing assistance to EITE industries, the Government does highlight the potential allocation of permits to coal-fired electricity generators on a once-and-for-all basis. It is envisaged that allocations would progressively move toward 100% auctioning.

Banking of surplus allowances

Banking (i.e. allowing permits from the current year cap to be stored) will be unlimited and there will be no expiry date.

International linkages

An objective of the scheme is to facilitate international linkage. In the short term however, the Government proposes that there will be limits on the number of international offset credits that liable firms can surrender for compliance. International units that would be accepted include certified emission reductions (CERs) created under the Kyoto Protocol's Clean Development Mechanism; emission reduction units (ERUs) created under the Joint Implementation mechanism; and removal units (RMUs) created in respect of land use, land use change and forestry activities.

The Government proposes not to allow the export of Australia's own Kyoto Protocol compliance units until at least 2013.

Addressing Market Failures

Funding from auction revenue will be used to help ensure a smooth transition for business, to help address market failures and to facilitate investment in household energy efficiency and carbon capture and storage (CCS).

A Climate Change Action Fund (CCAF) will be established as a transition measure to assist businesses more generally than the specific support the government is proposing to give to EITE businesses. It will apply where businesses can demonstrate clear, identifiable, and significant impacts that could be cost-effectively addressed with financial support. Final funding amounts and details are waiting on final scheme design, the Wilkins review, and consideration of the COAG assessment of complementary measures, but it is clear that partnership funding is intended for:

- capital-intensive new low emissions processes
- long-payback industrial energy efficiency
- dissemination of best and innovative practices to SMEs.

An Electricity Sector Adjustment Scheme (ESAS) is to be established, an important focus of which will be on CCS. The paper indicates that CCS is critical to achieving the 2050 target of a 60% cut, but the long-term and high-risk R&D involved will not be generated by scheme market forces.

Household energy efficiency measures and consumer information will be used to foster the many energy efficiency abatement options that might not flow directly from the market.

There is no indication at this stage as to the quantum of funding. Approximately \$5 billion in auction revenue per year could become available for distribution under the paper's commitment that every cent raised from the scheme will be used to help Australian households and businesses adjust to it and invest in clean energy options.

Regulation – Compliance and enforcement

Compliance

Consistent with reporting obligations under the NGER Act, entities with operational control over covered facilities or activities will be liable for obligations under the scheme. However, further consultation is to be carried out by the government in relation to applying the operational control approach to the forestry sector and upstream fuel suppliers.

Robust monitoring, reporting and assurance over emissions data are imperative for there to be a high level of market confidence. Estimation of emissions data is proposed based on methodologies currently available under the NGER system. More work is required to ensure sufficient accuracy and consistency of methods to be applied by entities covered by the scheme.

Reporting requirements will also be aligned to other existing mechanisms relating to fuel excise and customs duties. Liable entities will be required to surrender to the national registry, each financial year, a number of permits equal to their annual emissions. An administrative penalty could be imposed on liable entities if they surrender too few permits.

Role of regulator

A single body will be responsible for regulating both NGER and the CPRS. This body is likely to also provide guidance on the financial implications of data reported for both purposes. The Regulator will be set up in accordance with the *Financial Management and Accountability Act 1997*, and will have very wide-ranging responsibilities and a high level of operational independence.

Regulation/assurance over emissions data

Large emitters, with over 125,000 tonnes of greenhouse gas emissions a year, will be required to seek assurance from an accredited independent third-party over their annual emissions prior to submitting the information to the Government. This threshold is broadly in line with FY09 corporate-level reporting requirements of the NGER Act, except that for the purposes of the CPRS it will exclude electricity and liquid fuel emissions covered upstream. This significantly reduces the number of NGER reporting companies requiring assurance over their emissions for CPRS purposes.

However, companies will still need to understand the materiality of their carbon position on their financial performance and position. If the impact of the carbon cost is material to the company's results, or the auctioned permits and carbon trading are material to company cash flows, or the carbon emissions obligations, permit assets and other carbon related balances are material to the balance sheet, or even if the impact of the CPRS may be a 'material business risk' requiring disclosure under the ASX Corporate Governance principles, then the company's financial auditors will be required to audit or review these material transactions, balances and disclosures. This in turn will probably require the company to seek independent assurance over the underlying carbon emissions data.

In the footnote to the paper, it states that reasonable, or positive, assurance will be required over the company's compliance with its reporting obligations. The scheme regulator will also have the power to conduct audits of all emissions reports submitted under the scheme and could review reports submitted up to four years after.

The Government is working with the Auditing and Assurance Standards Board to develop auditing standards.

Public availability of emissions data

Emissions data is likely to be made publicly available soon after submission each year, in line with the approach in the NGER. The Government is seeking comment on whether the scheme should provide for the publication of more detailed emissions data (such as facility-level data).

Tax issues

Income Tax issues

The paper provides insight into the likely treatment of some of the key tax issues raised by the scheme although there will be many tax issues to resolve. The preferred approach is for specific income tax provisions to be enacted alongside the scheme law rather than to rely on existing tax law. However, there is little understanding as to whether there would be separate GST provisions. One of the key issues that will need to be addressed for large business is cash flow issues associated with taxing free permits upfront.

GST Issues

There is less clarity in relation to GST as the proposed position is to treat the variety of the scheme's transactions under normal GST rules. The paper only considers some of the transactions. It does not consider the complications of having different treatments depending on the transaction, nor treating some transactions as subject to GST.

An overview of the proposed income tax treatment of key aspects of the scheme

Purchasing and Selling Permits		
To meet an obligation under the scheme	<i>Acquiring via auction or on secondary market</i>	Deductible
	<i>Banking/Surrendering</i>	Rolling Balance Method to effect timing of deductions, similar to trading stock rules. Options for valuation include market value or historical cost.
	<i>Selling</i>	Assessable Income
To trade in the market		Utilise existing trading stock rules
For marketing or voluntary surrender		May be deductible as marketing costs If sold, assessable income
For investment		Not deductible Cost taken into account in determining gain or loss on disposal.
For private and domestic use		Not deductible
Penalties under the scheme		Not deductible
Compensation		
Free Permits		Assessable Income at the time received Where received and surrendered in same income year, deduction equal to amount included in assessable income (no net tax paid) If sold, Assessable income at time of sale
Cash Grants		Value assessable income at time received

Conclusion

Overall, the clarity provided by the Federal Government in its Green Paper on the Carbon Pollution Reduction Scheme will shift the issue of how Australian businesses respond to climate change from the desks of Corporate and Investor Affairs officers to the desks of Australia's CEOs. Boards will also have to take note in order to deal with governance implications of the scheme and in monitoring the company's overall response and performance in addressing its climate change risks and opportunities.

Important: Submissions from business on the Green Paper are due by 10 September 2008.

Sustainability & Climate Change Services

Climate Change has emerged as one of the most important political and business issues of our time. The prospect of future greenhouse gas constraints generates substantial risks and opportunities for businesses.

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For further information



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