Ref. BUSINESSEUROPE GREEN TAXATION GROUP January 22, 2013

To:
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BUSINESSEUROPE comments to the public consultation on the revised discussion draft on tax treaty issues related to emission permits and credits

BUSINESSEUROPE represents through its members 20 million European small, medium and large companies. Active in European affairs since 1958, BUSINESSEUROPE's members are 41 leading industrial and employers' federations from 35 European countries, working together to achieve growth and competitiveness in Europe.

BUSINESSEUROPE supports the work which the OECD has done to date and continues to undertake on the tax treaty issues related to emission trading systems. Given the development of Emission Trading systems in a number of member countries (particularly the EU ETS) and the efforts to link systems (as witnessed by the recent agreement between the EU and Australia) this work is both timely and important. Limiting potential tax obstacles to tradable emission permits and credits and tax arbitrage opportunities should improve the effectiveness of carbon markets. This should stimulate investments (in innovation) and reduce CO2 at the least cost.

BUSINESSEUROPE supports the OECD in its effort to promote a clear and coordinated interpretation of tradable emission permits and to include tradable emission credits in the scope of its revised discussion draft.

As the EU Emission Trading System (ETS) is moving to its next Phase and more permits will be auctioned from 1 January 2013, it is likely a number of member states will take a new look at the in country and cross border tax treatment of emission permit and credits. BUSINESSEUROPE supports OECD in using this window of opportunity to propose a general view on the cross border tax treatment of emission permits and credits. We believe it is important for member states to reject inconsistent interpretations that would potentially hinder an effective and efficient carbon market.

With regard to the specific issues:

1. BUSINESSEUROPE supports the OECD view that emission permits and credits should be considered as fungible and transferable rights.

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2. OECD believes cross border issuance of emission permits to be rather exceptional and therefore tax treaty issues regarding issuance will not be relevant. BUSINESSEUROPE suggests that it would be prudent not to ignore this issue without a review by an ETS expert regarding the options for centralized issuance and auctioning. Developments regarding the EU Emission Trading System (EU ETS) could lead to a more centralized issuance or auctioning of permits. Therefore, BUSINESSEUROPE believes OECD analysis on the subject to be worthwhile.
3. Regarding the issuance of a credit and its tax treatment, reference is made in Para. 17 to the moment certificates are issued as a taxable occasion contrary to the moment of alienation. BUSINESSEUROPE supports OECD's analysis that the moment of alienation would be the appropriate taxable occasion; it does not agree that the moment of issuance is the taxable occasion.
4. BUSINESSEUROPE considers OECD's proposal in Para 42 very helpful to assess the treaty characterization of the permits for an enterprise on the basis of the treaty characterization of the activities of the enterprise and on the link between the permits/credits and those activities. That link would allow the permits and credits to be taxed or its costs deducted in the same fashion as the activities the permits relate to. Any such link would no longer exist in subsequent sales, leaving the income to be considered under Articles 7 or 13. BUSINESSEUROPE would propose OECD to adjust 75.1, 2.1, and 14.1 accordingly.
5. The discussion draft does not consider the transfer pricing issues posed by emission trading credits and given the variety of views on this subject, it would be useful for this to be covered. Where an emission reduction project is conducted in country A at a lower cost to the cost of an emission permit in country B, the question of where the "profit" arises will occur. Is the profit created primarily by the emission trading system in country B or by the emission reduction project in country A? How should the profit be allocated between countries A and B? Given the potential financial flows involved, it would be helpful if this very important issue was covered in the discussion draft particularly as the countries where emission reduction projects are developed may take a very different view as to where value arises to countries operating emission markets. An example of the issue is attached in annex.

It is interesting to note that Australia is one of the few countries that has introduced specific laws on how to tax registered emissions units (at paragraph 29 of the OECD paper it's mentioned that "domestic tax laws of most countries make no express provisions with respect to emission permits")

In regards paragraph 32 of the paper, Australia is unlikely to look to tax permit trading or profits under CGT provisions. In this regard, in almost all circumstances emissions units and credits have been removed from the CGT net.

Australia appears to have one scheme only at present that would produce emission reduction credits / units (being the Carbon Farming Initiative credits). These credits are effectively treated as tax free on issuance. This treatment should make the analysis somewhat simpler in the unlikely event a participant receiving such credits was a non-resident without an Australian PE (in reference to the discussion from paragraph 18 of the OECD paper).

This exemption for Carbon Farming Initiative credits is also likely to mean that Australia won't look to use the Immoveable Property article to tax such credits (see proposed new paragraph 2.1 to the Commentary on article 6)

Australia now has a regime that allows for shipping profits to be exempted from income tax (as per many jurisdictions). As such the proposed new commentary for article 8 may not have much practical impact in most instances but nonetheless seems a necessary addition to the commentary.

BUSINESSEUROPE supports the work which the OECD has done to date and continues to undertake on the tax treaty issues related to emission trading systems. The Australian examples above illustrate the need for all country participants in Emission Trading Systems to develop rules both for domestic and cross border tax issues as these systems operate.

We would appreciate the continued opportunity to participate in any consultation on this work which OECD undertakes. While it is beyond the scope of the current work and consultation, we would encourage the OECD to complement this project with the development of a statement of best practice on the domestic treatment of emission trading permits.

On behalf of the BUSINESSEUROPE Green Taxation Group

January, 22 2013

Chris Lenon

Chairman

Annex

OECD consultation on tax treaty issues related to emission permits/credits:

Transfer pricing issues

The discussion draft does not consider the transfer pricing issues posed by emission trading credits and given the variety of views on this subject, BUSINESSEUROPE suggests it would be useful for this to be covered. The following example explores some of the issues and potential areas of disagreement.

Where an emission reduction project is conducted in Country A at a lower cost than that of an emission permit in Country B, the question of where the “profit” arises will occur. Let us assume that the price for acquiring emission trading permits in the ETS is 15 euro and that the cost of producing a credit in Country A in Africa is 7 euro. A company in Country B within the EU buys a credit from a connected party in Country A in Africa (there is no intermediary group company). Clearly if a genuine comparable transaction can be found then this price should be used, but what is the position in the absence of a comparable?

It has been suggested by Taxud officials that the value of the credit derives primarily from the operation of the EU ETS, and not the production of the credit in the project in Africa. They have also indicated that the transfer price to be paid to Country A would be close to the cost of production (say 9 Euros) and that most of the benefit would arise in Country B as the company would be acquiring the offset credit at a lower price than the ETS permit price. This position is based on the assumption that the market provides the more significant part of the value in a profit split. This is not necessarily consistent with the position taken in OECD deliberations in general on profit split.

It is also possible to argue that a significant part of the value should be deemed to arise in Country A given the risks assumed in the creation of the credit.

It would be helpful if the OECD could consider this issue. Is the profit created primarily by the emission trading system in country B or by the emission reduction project in country A? How should the profit be allocated between countries A and B? What is the appropriate profit split? Given the potential financial flows involved, it would be helpful if this very important issue was covered in the discussion draft particularly as the countries where emission reduction projects are developed may take a very different view as to where value arises to countries operating emission markets with the risk that double taxation may arise and the costs of carbon reduction projects in Developing Countries would therefore increase.