2009

EXPOSURE DRAFT

CARBON POLLUTION REDUCTION SCHEME (CONSEQUENTIAL AMENDMENTS) BILL 2009

COMMENTARY

(Circulated by the authority of the Minister for Climate Change and Water, Senator the Hon Penny Wong)

Note

The Commentary has been prepared for the purpose of assisting readers to understand the exposure draft of the Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009. When the bills are introduced into Parliament, an explanatory memorandum will be tabled which may differ from this Commentary.

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Glossary

The following abbreviations and acronyms are used in this commentary.

Abbreviation	*Definition*
The main bill	Carbon Pollution Reduction Scheme Bill 2009
Authority	Australian Climate Change Regulatory Authority
CFCs	chlorofluorocarbon
CGT	Capital gains tax
The consequential amendments bill	Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009
Eligible international emissions unit	A certified emission reduction (other than a temporary certified emission reduction or a long-term certified emission reduction), an emission reduction unit, a removal unit, a prescribed unit issued in accordance with the Kyoto rules.
Garnaut Climate Change Review Final Report; Garnaut Final Report	R. Garnaut, *The Garnaut Climate Change Review: Final Report*, Cambridge University Press, 2008
Green Paper	*Carbon Pollution Reduction Scheme Green Paper*, July 2008
GST	Goods and services tax
GST Act	*A New Tax System (Goods and Services Tax) Act 1999*
HCFCs	hydrochlorofluorocarbons
HFCs	hydrofluorocarbons
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
Kyoto unit	An assigned amount unit, a certified emission reduction, an emission

	reduction unit, a removal unit or a prescribed unit issued in accordance with the Kyoto rules.
MEC Group	Multiple entry consolidated group
The National Registry	National Registry of Emissions Units
PAYG	Pay as you go
PFCs	perfluorocarbons
The Scheme	The Carbon Pollution Reduction Scheme
Scheme entities	Entities which are subject to the Carbon Pollution Reduction Scheme
SF_6	Sulphur hexafluoride
TAA 1953	*Taxation Administration Act 1953*
White Paper	*Carbon Pollution Reduction Scheme: Australia's Low Pollution Future*, White Paper, December 2008

General outline

The Carbon Pollution Reduction Scheme

The rationale for the Carbon Pollution Reduction Scheme is included in the commentary on the draft Carbon Pollution Reduction Scheme Bill 2009 (the main bill).

In brief, the Government accepts the key findings of the Garnaut Climate Change Review Final Report that:

- a fair and effective global agreement delivering deep cuts in emissions consistent with stabilising concentrations of greenhouse gases at around 450 parts per million or lower would be in Australia's interests
- achieving global commitment to emissions reductions of this order appears unlikely in the next commitment period
- the most prospective pathway to this goal is to embark on global action that reduces the risks of dangerous climate change and builds confidence that deep cuts in emissions are compatible with continuing economic growth and improved living standards.

The Government's climate change policy is built on three pillars—reducing Australia's carbon pollution, adapting to the impacts of climate change that we cannot avoid, and helping to shape a global solution.

The first element, reducing Australia's carbon pollution, will be managed through:

- the implementation of the Carbon Pollution Reduction Scheme (the primary tool for driving reductions in greenhouse gas emissions)
- an expanded national Renewable Energy Target
- investment in renewable energy technologies and in the demonstration of carbon capture and storage
- action on energy efficiency.

The Carbon Pollution Reduction Scheme Bill 2009 will implement the Carbon Pollution Reduction Scheme. It is described in a separate commentary.

The Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009

Introduction

The Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009 includes consequential amendments and transitional provisions.

The consequential amendments include amendments to the *National Greenhouse and Energy Reporting Act 2007* and the taxation legislation to accommodate the new Scheme.

The transitional provisions include some of those which are necessary as the result of amendments which will transfer the functions of the Greenhouse and Energy Data Officer under the *National Greenhouse and Energy Reporting Act 2007* and the Renewable Energy Regulator under the *Renewable Energy (Electricity) Act 2000* to the Australian Climate Change Regulatory Authority.

Additional consequential amendments will be developed in the interval between release of the exposure draft and finalisation of the Bill for introduction.

Structure of the commentary

Amendments to the *National Greenhouse and Energy Reporting Act 2007* are described in Chapter 1 of this commentary.

Amendments to the taxation legislation are described in Chapter 2.

Amendments to the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* are described in Chapter 3.

Amendments to other legislation are described in Chapter 4.

The transitional and application provisions in Schedule 1 are described in Chapter 5, as is a proposed amendment to the *Anti-Money Laundering and Counter Terrorism Financing Act 2006*.

Date of effect: Part 1 of Schedule 1, and Schedule 2 will come into effect at the same time as section 3 of the proposed *Carbon Pollution Reduction Scheme Act 2009*. Part 2 of Schedule 1 will come into effect on 1 July 2010.

Proposal announced: The measures are based on the positions included in the White Paper entitled *Carbon Pollution Reduction Scheme: Australia's Low Pollution Future* released by the Government on 15 December 2008.

Financial impact: A statement as to financial impact will be available at the time of introduction.

Compliance cost impact: A statement as to compliance cost impact will be available at the time of introduction.

Regulation Impact Statement: A Regulation Impact Statement will be available at the time of introduction.

Chapter 1
Amendments to the National Greenhouse and Energy Reporting Act 2007

Outline of Chapter

1.1 The Carbon Pollution Reduction Scheme (the Scheme) places obligations on entities (Scheme entities) in relation to their emissions which are reported under the *National Greenhouse and Energy Reporting* Act. Consequential amendments are required to enable this and also to strengthen specific elements of the *National Greenhouse and Energy Reporting Act 2007* to support the Scheme.

1.2 This chapter discusses the amendments to the *National Greenhouse and Energy Reporting Act 2007* which are set out in the draft Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009 (the draft consequential amendments bill) and outlines further consequential amendments to be made after release of the exposure draft. These additional amendments are more detailed and technical in nature.

Context of amendments

1.3 The *National Greenhouse and Energy Reporting Act 2007* provides a national framework for the reporting of information related to greenhouse gas emissions, energy consumption and energy production.

1.4 Many Scheme entities will already be reporting under the *National Greenhouse and Energy Reporting Act 2007*. To maintain the Government's commitment in the White Paper to the streamlining of reporting of greenhouse and energy data, including for liable entities, the *National Greenhouse and Energy Reporting Act 2007* will require reporting of greenhouse gas emissions covered by the Scheme. As that Act was put in place prior to the development of the Scheme it needs to be amended to support the Scheme.

1.5 In line with the Government's commitment to the streamlining of reporting of greenhouse gas emissions and energy data, one report will satisfy an entity's reporting requirements for the Scheme and current reporting requirements under section 19 of the *National Greenhouse and Energy Reporting Act 2007*.

1.6 As outlined in the White Paper, the Government's policy is to establish a single regulator, the Australian Climate Change Regulatory Authority (the Authority), to administer the Scheme and be responsible for the functions of the Renewable Energy Regulator and the Greenhouse and Energy Data Officer. The establishment of the Authority is discussed further in the commentary on the draft Australian Climate Change Regulatory Authority Bill.

Summary of new law

1.7 The consequential amendments to the *National Greenhouse and Energy Reporting Act 2007* are in Schedule 1 of the draft consequential amendments bill. This Schedule is divided into two Parts:

- Part 1 deals with amendments commencing at the same time as clause 3 of the Carbon Pollution Reduction Scheme Bill 2009 (the main bill) commences (that is 28 days after the main bill and the Acts listed in clause 3 receive Royal Assent). The relevant amendments in this Part are concerned with replacing references to the Greenhouse and Energy Data Officer with references to the Authority.

- Part 2 includes amendments to the *National Greenhouse and Energy Reporting Act 2007* that commence on 1 July 2010.

1.8 This approach is adopted because the administration of the *National Greenhouse and Energy Reporting Act 2007* by the Greenhouse and Energy Data Officer will change when clause 3 of the main bill commences while reporting under the *National Greenhouse and Energy Reporting Act 2007* will change from 1 July 2010, the start of the Scheme.

Part 1 Amendments

Replacement of references to the Greenhouse and Energy Data Officer

1.9 Currently the Greenhouse and Energy Data Officer is responsible for administration of the *National Greenhouse and Energy Reporting Act 2007* and is established under section 49 of that Act. References to the Greenhouse and Energy Data Officer will be replaced with references to the Authority.

Part 2 Amendments

Definitions

1.10 Key definitions will be amended so that they apply consistently to Scheme entities across both the main bill and the *National Greenhouse and Energy Reporting Act 2007*.

Emissions and greenhouse gases

1.11 The definition of 'emissions' will be revised to separate scope 1 (direct) from scope 2 (indirect emissions). This will enable different reporting requirements to be applied to entities that have reporting requirements under the Scheme and those that do not.

1.12 The definition of 'greenhouse gas' will be amended in the *National Greenhouse and Energy Reporting Act 2007* and to allow further greenhouse gases to be defined in regulations.

Persons

1.13 A definition of 'person' will be included as the *National Greenhouse and Energy Reporting Act 2007* will be expanded to include not only constitutional corporations, but other types of entities that have obligations under the Scheme.

Operational control

1.14 The definition of 'operational control' will be amended so that it applies to all persons and addresses circumstances where more than one entity has authority over the operating and environmental policies of a facility.

Registration

1.15 An amendment will be made to require registration under the *National Greenhouse and Energy Reporting Act 2007* by Scheme liable entities.

Reporting

1.16 An amendment will be made to require reporting under the *National Greenhouse and Energy Reporting Act 2007* by Scheme entities. Different reporting requirements may apply in different circumstances. This segment of the commentary also discusses the effect of liability transfer certificates on group thresholds and reporting.

Methodologies

1.17 The *National Greenhouse and Energy Reporting (Measurement) Determination 2008* will be strengthened and updated to allow for reporting by Scheme entities and to provide for more accurate reporting under the Scheme, as outlined in the White Paper.

Audit

1.18 Entities that have obligations for more than 125,000 tonnes of emissions in carbon dioxide equivalent will be required to have their emissions reports audited prior to submission. The *National Greenhouse and Energy Reporting Act 2007* will be amended to require this.

Other general amendments

1.19 Other amendments will be made to align the *National Greenhouse and Energy Reporting Act 2007* with the main bill. This will make understanding the legislation and compliance simpler for entities with obligations under both pieces of legislation.

Comparison of key features of new and current law

New law	*Current law*
Emissions, scope 1 (direct) and scope 2 (indirect) emissions will be defined separately in regulations	The definition of emissions includes scope 1 (direct) and scope 2 (indirect) emissions
The statutory authority that is responsible for enforcing the *National Greenhouse and Energy Reporting Act 2007* is the Australian Climate Change Regulatory Authority (the Authority)	The statutory authority that is responsible for enforcing the *National Greenhouse and Energy Reporting Act 2007* is the Greenhouse and Energy Data Officer
Defines potential greenhouse gas emissions embodied in an amount of eligible upstream fuel	Potential greenhouse gas emissions are not included in the *National Greenhouse and Energy Reporting Act 2007*
Greenhouse gas reporting obligations can apply to all legal entities defined as a 'person'	Greenhouse gas reporting obligations only apply to controlling corporations
Operational control is amended to: include persons; allow for a declaration of	Operational control and the Greenhouse and Energy Data Officer's ability to declare operational control only applies to

New law	***Current law***
operational control by the Authority in relation to persons; and to require the nomination of a liable entity where entities have equal authority, eg joint ventures, partnerships, trusts	controlling corporations.
Facility and activity definitions amended to include carbon capture and storage, and landfill facilities	Facility and activity definitions do not include situations where there are no operations occurring (for example closed landfill facilities)
Scheme entities will have to register and meet reporting obligations under the *National Greenhouse and Energy Reporting Act 2007*. Reporting requirements will not include scope 2 (indirect emissions).	Only controlling corporations that meet *National Greenhouse and Energy Reporting Act 2007* thresholds are required to register and meet reporting obligations
Where an entity has elected to use a higher order method it must do so for a minimum of four years	No restrictions on maintaining a higher order methodology where an entity elects to use one
Large emitters (those with obligations under the Scheme for greenhouse gas emissions of 125,000 tonnes of carbon dioxide equivalent or more) will be required to have their annual emissions reports audited by an independent third party before submitting them to the Authority	No pre-submission audit required for emissions reports under the *National Greenhouse and Energy Reporting Act 2007*
Record keeping requirement is five years for the Scheme and the *National Greenhouse and Energy Reporting Act 2007*	Record keeping requirement is seven years for the *National Greenhouse and Energy Reporting Act 2007*

Application and transitional provisions

1.20 Transitional provisions are discussed in Chapter 5 of the commentary on the draft consequential amendments bill.

Consequential amendments

Replacement of references to the Greenhouse and Energy Data Officer

1.21 As discussed above, references to the Greenhouse and Energy Data Officer will be replaced with references to the Authority. ***[Schedule 1, Part 1, items 13-66]***

Definitions

Overview

1.22 This section outlines amendments that will be made to the *National Greenhouse and Energy Reporting Act 2007* to incorporate new definitions, amend existing definitions and include definitions that will have the same meaning under the main bill and the *National Greenhouse and Energy Reporting Act 2007* as a consequence of the main bill.

Emissions

1.23 The definition of 'emissions' under the *National Greenhouse and Energy Reporting Act 2007* currently encompasses scope 1 (direct) and scope 2 (indirect) emissions. Scheme liability is attached to a subset of scope 1 emissions of greenhouse gas. The *National Greenhouse and Energy Reporting Act 2007* will be amended to take this into account so that scope 1 emissions and scope 2 emissions are separately defined. ***[Schedule 1, Part 2, item 116]***

1.24 A 'scope 1 emission' and a 'scope 2 emission' will be defined by section 10 of the *National Greenhouse and Energy Reporting Act 2007*. ***[Schedule 1, Part 2, items 137-138]*** This Section will be amended to allow for scope 1 and scope 2 emissions to be prescribed in regulations. Proposed subsection 10(2A) of the *National Greenhouse and Energy Reporting Act 2007* will provide that the regulations must declare that specified scope 1 emissions are covered by the Scheme (and therefore lead to liability under the Scheme as outlined in Chapter 1 of the commentary on the main bill). ***[Schedule 1, Part 2, items 156-162]***

Greenhouse gas

1.25 The definition of 'greenhouse gas' will be amended so that it applies for the purposes of both the main bill and the *National Greenhouse and Energy Reporting Act 2007* and to allow for specific hydrofluorocarbons and perfluorocarbons to be identified as greenhouse gases within the *National Greenhouse and Energy Reporting Act 2007*, rather than in regulations as is currently the case.

1.26 Amendments will also allow the regulations to prescribe new greenhouse gases if required. It is intended that a new greenhouse gas would only be included in regulations if it becomes a gas that is agreed internationally to be included for the purposes of meeting Australia's international emissions reduction obligations. If a new gas is included for these purposes it is most likely to be a synthetic greenhouse gas. A new gas will not be added during the first commitment period of the Kyoto Protocol 2008-2012. ***[Schedule 1, Part 2, item 146] [Schedule 1, Part 2, item 120] [Schedule 1, Part 2, item 140]***

Carbon dioxide equivalence

1.27 'Carbon dioxide equivalence' (CO_2-e) will be defined in the *National Greenhouse and Energy Reporting Act 2007*. [Part 1, clause 5] This definition will provide for calculating:

- the carbon dioxide equivalence of an amount of greenhouse gas
- the carbon dioxide equivalence of an amount of potential greenhouse gas emissions embodied in an amount of an eligible upstream fuel.

[Schedule 1, Part 2, items 112, 146]

1.28 The carbon dioxide equivalence of an amount of greenhouse gas (metric weight) means the amount of the gas multiplied by a value specified in the *National Greenhouse and Energy Reporting Regulations 2008* in relation to that kind of greenhouse gas. This value is the internationally accepted global warming potential for that gas.

Potential greenhouse gas emissions

1.29 To allow for the reporting of emissions numbers arising from eligible upstream fuels:

- 'Potential greenhouse gas emissions embodied in an amount of eligible upstream fuel' and their carbon dioxide equivalent will be defined to allow for reporting of emissions from eligible upstream fuels.

[Schedule 1, Part 2, item 135] [Schedule 1, Part 2, item 146]

Liable entities, controlling corporations and corporate groups

1.30 As the *National Greenhouse and Energy Reporting Act 2007* currently only applies to controlling corporations, an amendment will include the definition of a 'person' in the *National Greenhouse and*

Energy Reporting Act 2007 to include all legal entities covered by the main bill. ***[Schedule 1, Part 2, item 134] [Schedule 1, Part 2, item 127]***

1.31 To reflect the approach under the Scheme to liability and operational control over a facility, the definition of 'groups' under the *National Greenhouse and Energy Reporting Act 2007* will be amended and references to joint ventures and partnerships will be removed. (For detail on the treatment of joint ventures, partnerships and trusts, see Chapter 1 commentary on the main bill, particularly the segment relating to *operational control*). ***[Schedule 1, Part 2, items 147-149] [Schedule 1, Part 2, item 128] [Schedule 1, Part 2, item 142]***

1.32 A provision has been included to avoid doubt that a controlling corporation's group may consist of the controlling corporation alone. ***[Schedule 1, Part 2, item 150]***

1.33 A definition of a 'non-group entity' will be included to identify entities that are not a member of a controlling corporation's group - that is not a constitutional corporation. ***[Schedule 1, Part 2, item 129]*** These entities will only have obligations under the *National Greenhouse and Energy Reporting Act 2007* because of obligations under the main bill.

Operational control

1.34 The definition of 'operational control' will be amended so that it underpins both the main bill and the *National Greenhouse and Energy Reporting Act 2007*. This means that it will be amended to pick up any 'person', rather than only controlling corporations and members of their groups. ***[Schedule 1, Part 2, items 163-170]***

To support this inclusion and the Scheme's approach to entities with operational control over a facility, the definition of operational control in the National Greenhouse and Energy Reporting Act 2007 will be amended to include an operational control provision for the person who has the greatest authority (11A); a provision that relates to circumstances where more than one person has authority (11B) and (11C). (For detail on these provisions, see Chapter 1 commentary on the main bill, particularly the segment on operational control). **[Schedule 1, Part 2, items 171-172] [Schedule 1, Part 2, item 132]**

1.35 The *National Greenhouse and Energy Reporting Act 2007* will be amended to allow the Authority to make a declaration in regard to operational control in relation to a non-group entity either on application by the non-group entity or on at the Authority's own initiative. ***[Schedule 1, Part 2, item 191] [Schedule 1, Part 2, item 193]*** Currently the *National Greenhouse and Energy Reporting Act 2007* provides for such declarations only in relation to constitutional corporations.

1.36 The *National Greenhouse and Energy Reporting Act 2007* will also be amended so that the Authority cannot declare operational control on application by a member of a group unless it is satisfied that the corporation or member has substantial authority over operating, health and safety and environmental policies and the member's controlling corporation has consented to the application being made. ***[Schedule 1, Part 2, item 190]***

Facility

1.37 The definition of a 'facility' will be amended so that it applies to both the *National Greenhouse and Energy Reporting Act 2007* and the main bill and to allow for the declaration of a facility by the Authority that is under the operational control of either a controlling corporation or a non-group entity. ***[Schedule 1, Part 2, items 151-153] [Schedule 1, Part 2, item 188A] [Schedule 1, Part 2, item 189] [Schedule 1, Part 2, item 192]***

1.38 The limitation of the definition of a 'facility' and 'greenhouse gas projects' to oil and gas extraction activities in the exclusive economic zone will be removed so that the *National Greenhouse and Energy Reporting Act 2007* can apply to emissions such as those from carbon storage facilities under the sea bed. ***[Schedule 1, Part 2, items 121-122] [Schedule 1, Part 2, item 154] [Schedule 1, Part 2, item 130]***

1.39 The *National Greenhouse and Energy Reporting Act 2007* will be amended to define 'carbon capture and storage' and ensure that it is covered both on land and offshore within the territorial boundary of the Act (see below for detail on the boundary under the section *territorial boundary*). ***[Schedule 1, Part 2, item 110] [Schedule 1, Part 2, item 111]***

1.40 To allow for the coverage of emissions from solid waste the definition of activity in relation to a facility will be expanded ***[Schedule 1, Part 2, item 110]***

1.41 In addition, 'operation' in relation to a facility will be defined to include the subsistence of the facility. For example a closed landfill facility continues to emit greenhouse gas emissions and is therefore still considered to be operational even though waste is no longer being received. ***[Schedule 1, Part 2, item 131]***

1.42 The question as to which industry sector a facility belongs is used for statistical purposes only and not for determining what a facility is. The information required for identifying the industry sector for a facility is required in regulations made under subparagraph 19(6)(c). Therefore subsection 9(3) will be removed from the *National Greenhouse and Energy Reporting Act 2007*. ***[Schedule 1, Part 2, item 155]***

Approved

1.43 A definition of 'approved' has been included to make it clear that where the Authority has approved something, this means that it has done so in writing, for the purposes of the provision in which the term occurs. This also ensures that such a provision will attract the provisions in the *Acts Interpretation Act 1901* concerning varying and revocation. ***[Schedule 1, Part 2, item 110A]***

Further amendments to definitions

1.44 The terms listed below will be defined in the *National Greenhouse and Energy Reporting Act 2007* by reference to another Act.

- 'carbon pollution reduction scheme' ***[Schedule 1, Part 2, item 112A]***
- 'continental shelf' ***[Schedule 1, Part 2, item 113]***
- 'eligible financial year' ***[Schedule 1, Part 2, item 114]***
- 'eligible upstream fuel' ***[Schedule 1, Part 2, item 115]***
- 'emissions number' ***[Schedule 1, Part 2, item 117]***
- 'import' ***[Schedule 1, Part 2, item 123]***
- 'liable entity' ***[Schedule 1, Part 2, item 126]***
- 'provisional emissions number' ***[Schedule 1, Part 2, item 136]***
- 'supply' ***[Schedule 1, Part 2, item 139]***
- 'territorial sea' ***[Schedule 1, Part 2, item 141]***
- 'trustee' ***[Schedule 1, Part 2, item 143]***
- 'trust estate' ***[Schedule 1, Part 2, item 144]***

Registration

1.45 The *National Greenhouse and Energy Reporting Act 2007* will be amended to require Scheme entities to register by 31 August following the first financial year in which they are liable. Liable entities, registered under that Act, will need to be able to de-register subject to requirements. These requirements will be based on subsection 18(3) of the *National Greenhouse and Energy Reporting Act 2007*. This includes the requirement that an entity is not likely to be liable for (a) the financial

year in which the application is made; and (b) the next two financial years before it can be deregistered. Following this amendment, all entities reporting under the *National Greenhouse and Energy Reporting Act 2007* will be able to de-register if they meet the requirements under both subsection 18(3) relating to emissions thresholds and the yet to be drafted new clause based on subsection 18(3) relating to their status as a Scheme entity. ***[Schedule 1, Part 2, item 173]***

Reporting

1.46 Noting the Government's commitment to the streamlining of reporting of greenhouse gas emissions, energy consumption and energy production data, a single emissions report will satisfy an entity's obligations under both the *National Greenhouse and Energy Reporting Act 2007* and the Scheme.

1.47 Liable entities will be required to report emissions to the Authority by 31 October each year following the reporting (financial) year. The *National Greenhouse and Energy Reporting Act 2007* will be amended to require reporting of matters relevant to liability under the Scheme, including the calculation of their provisional emissions number and final emissions number. Entities are also required to report scope 1 emissions of greenhouse gases, import, manufacture and supply of synthetic greenhouse gases and potential greenhouse gas emissions embodied in an amount of upstream eligible fuels, where those matters result in provisional emissions numbers.

1.48 The *National Greenhouse and Energy Reporting Act 2007* will also be amended to allow regulations to specify different reporting requirements in different circumstances. For example, additional reporting requirements will apply in regulations to entities that either use an obligation transfer number (OTN), or accept an OTN. An OTN enables the transfer of or exemption from scheme obligations from upstream suppliers of fuels and synthetic greenhouse gases to intermediate suppliers and end users of these fuels and gases (see Chapter 1 of the commentary on the main bill for a detailed explanation). Examples of the type of information that may be required by regulations are quantities of different types of fuel supplied to a person under an OTN and re-supplied to another person, including amounts supplied to specific OTNs.

1.49 Provisions drafted for reporting also include a general record keeping requirement. That requirement will be amended to require a 'person' to retain records for five years, in line with standard taxation record keeping obligations, for both Scheme entities and entities liable under the *National Greenhouse and Energy Reporting Act 2007*. ***[Schedule 1, Part 2, items 175-181]***

1.50 Liable entities will be subject to penalties if they fail to comply with reporting requirements under new section 22A or if they fail to comply with external audit provisions. ***[Schedule 1, Part 2, item 188]***

Example 1.1

Existing reporter – not liable under the Scheme

Company A consumes 250 terajoules of energy and has direct emissions of 5000 tonnes CO_2-e in 2010-2011. It therefore has obligations to register and report because it meets an energy threshold under section 13 of the *National Greenhouse and Energy Reporting Act 2007*. It is not a liable entity under the Scheme.

Company A's reporting requirements under the *National Greenhouse and Energy Reporting Act 2007* will remain unchanged and it will not have any additional reporting obligations due to the Scheme.

Example 1.2

Existing reporter – liable under the Scheme

Company B has obligations to register and report because it has operational control over a facility with typical annual scope 1 (direct) emissions of 35,000 tonnes CO_2-e. It therefore meets the threshold under section 13(d) of the *National Greenhouse and Energy Reporting Act 2007*. It will become a liable entity from 1 July 2010.

Company B's reporting requirements under the *National Greenhouse and Energy Reporting Act 2007* will remain unchanged and it will have additional reporting requirements due to the Scheme from 1 July 2010 onwards such as:

- the calculation of its provisional emissions number
- the calculation of its final emissions number

Example 1.3

New reporting entity – direct emitter

A local governing body is a Scheme entity from 1 July 2010 due to emissions from its landfill facility, but was not previously captured by the *National Greenhouse and Energy Reporting Act 2007* as it is not a constitutional corporation.

The local governing body will have reporting obligations from 1 July 2010 onwards such as:

- specified scope 1 (direct) emissions covered by the Scheme
- the calculation of its provisional emissions number
- the calculation of its final emissions number

The local governing body will not have any other obligations under the *National Greenhouse and Energy Reporting Act 2007* such as reporting of scope 2 (indirect) emissions, energy production and energy consumption.

Example 1.4

New reporting entity – independent importer and distributor of petroleum

Company C is an independent importer of and distributor of petroleum. It blends, but does not refine petroleum and is therefore not a significant energy producer or consumer and has no scope 1 (direct) emissions. It therefore does not meet a threshold under section 13 of the *National Greenhouse and Energy Reporting Act 2007* but will be a Scheme entity from 1 July 2010.

Company C will have to report information from Scheme commencement such as:

- potential greenhouse gas emissions embodied in the petroleum that it imports
- information required by regulation such as fuel sold under an OTN
- the calculation of its provisional emissions number
- the calculation of its final emissions number

Company C will not have any other obligations under the *National Greenhouse and Energy Reporting Act 2007* such as reporting of: scope 1 emissions that are not covered by the Scheme; scope 2 (indirect) emissions; energy production; and energy consumption.

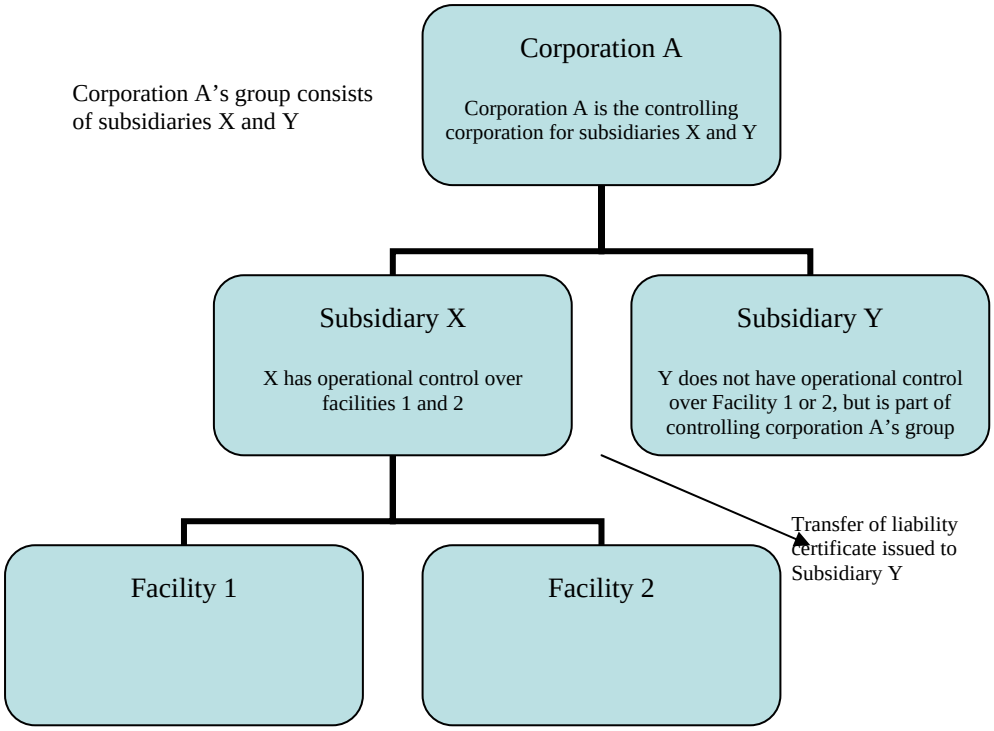
Liability transfer certificates – effect on group thresholds and reporting

1.51 The reporting obligations for a facility to which a liability transfer certificate applies will also be transferred to the holder of the certificate. In this instance, for the purposes of calculating group thresholds under section 13 of the *National Greenhouse and Energy Reporting Act 2007*, with regard to registration and reporting, the

emissions from that facility will count towards the corporate group of the holder of the liability transfer certificate. (See Part 2, Division 6 of the main bill for provisions on liability transfer certificates). This provision is yet to be drafted.

1.52 In practice, this means that where an entity transfers liability within a group, thresholds will be unaffected.

Example 1.5



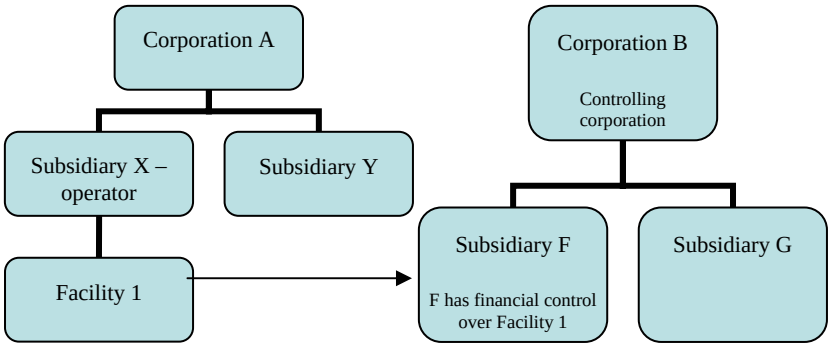
Liability transfer certificate is issued for Subsidiary Y in relation to Facility 2.

Facility 2 will continue to form part of Corporation A's group for the purposes of meeting the audit threshold under the Scheme for entities with a liability of 125,000 tonnes or more of greenhouse gas in CO_2-e and for meeting group thresholds under the *National Greenhouse and Energy Reporting Act 2007*.

1.53 However, thresholds will be affected in the case of a transfer of liability from the operator to the entity with financial control.

1.54 Where liability is transferred from the operator to another entity under a category B transfer test (financial control), to ensure that only one entity is liable in relation to a particular facility, the emissions from a facility held under a liability transfer certificate will not count towards the calculation of group thresholds for the operator.

Example 1.6



Liability transfer certificate issued to Subsidiary F

Corporation A will be taken to not have obligations or liability for Facility 1 under the Scheme or under the *National Greenhouse and Energy Reporting Act 2007*.

Facility 1 will form part of Corporation B's group for the purposes of meeting the audit threshold under the Scheme for entities with a liability of 125,000 tonnes CO_2-e and for meeting the group and facility thresholds.

1.55 These rules will also count towards the calculation of group thresholds for the purposes of determining whether a controlling corporation meets the 125,000 tonnes audit threshold. (For more information on the audit threshold, see the section below on audit.) This provision is yet to be drafted.

Methodologies

1.56 Emissions estimation methodologies under the Scheme will be those set out under the *National Greenhouse and Energy Reporting (Measurement) Determination 2008* that is made by the Minister under

sub-section 10(3) of the *National Greenhouse and Energy Reporting Act 2007*.

1.57 Some entities will be required to use restricted methodologies under the Scheme. These entities include:

- Electricity generators will be required to use Methods 2–4 (as required under the *National Greenhouse and Energy Reporting (Measurement) Determination 2008*).
- Liable entities reporting PFC emissions from aluminium smelting processes will be required to use Methods 2–4.
- Entities reporting fugitive emissions from underground coal mines will be required to use Methods 2–4.
- Solid waste landfill sites will be required to use Methods 1–3 to estimate the proportion of legacy emissions arising from landfill sites.

1.58 Where an entity has elected to use Method 2 or above for a particular source in respect of a particular facility, that methodology will be the minimum standard for that particular source at that particular facility for that entity, for a period of four years.

1.59 The National Greenhouse and Energy Reporting (Measurement) Determination 2008 will be amended to include a national default emissions factor for calculating the potential greenhouse gas emissions from an eligible upstream fuel. If an entity obtains a fuel under an OTN, it will be required to report emissions related to fuels in accordance with the requirements set out for direct emitters. (See Chapter 1 of the main bill commentary for more detail.)

1.60 Provisions relating to these policy decisions are expected to be included in amendments to the National Greenhouse and Energy Reporting (Measurement) Determination 2008. These amendments are expected to be made shortly after the CPRS Act comes into effect.

Audit

1.61 The *National Greenhouse and Energy Reporting Act 2007* is currently being amended by the National Greenhouse and Energy Reporting Amendment Bill 2009 to provide an improved framework for external auditors and audits. These amendments are required in the short term to ensure the proper functioning of the current Act. For information on the National Greenhouse and Energy Reporting Amendment Bill 2009 see http://www.climatechange.gov.au/reporting/consultation.html.

1.62 External audit amendments in the main bill and the draft consequential amendments bill will be revised following comments on the exposure draft of the National Greenhouse and Energy Reporting Amendment Bill 2009 that closed on 2 March 2009.

1.63 In the longer term it is proposed that audit functions required for the purposes of the Scheme, the *National Greenhouse and Energy Reporting Act 2007* and the Renewable Energy Target scheme will be consolidated, where appropriate, in new provisions in legislation establishing the Authority. The aim of this approach is to provide the Authority with an integrated framework for auditing across these legislative schemes. The framework would accommodate auditing of emissions reports, and of data provided, for example, under the emissions intensive trade exposed assistance program under the Scheme.

1.64 The external audit provisions for inclusion in the ACCRA bill will be developed between release of the exposure draft of the Scheme legislation and introduction (March – May 2009).

1.65 The legislation will reflect the White Paper policy position that large emitters (those with obligations under the Scheme for greenhouse gas emissions of 125,000 tonnes of CO_2-e or more) will be required to have their annual emissions reports audited by an independent registered auditor before submitting them to the Authority. The threshold for this requirement will be set out in regulations as this allows the Government to adjust the threshold following review of the Scheme.

1.66 The *National Greenhouse and Energy Reporting Act 2007* will be amended to apply the existing external audit provisions to non-group entities. ***[Schedule 1, Part 2, item 194]*** The National Greenhouse and Energy Reporting Amendment Bill 2009, as discussed above, will insert a new section 74A. Item 194 of the consequential amendments bill will insert new sections 74B and 74C, which follows the order in which the amendments are expected to be made.

1.67 The definition of external auditor will be amended to provide for the auditing of non-group entities. ***[Schedule 1, Part 2, item 119]***

Public Disclosure

1.68 The Authority will publish, for each eligible financial year, a Scheme entity's (if any):

- total provisional emissions numbers
- the total of the entity's provisional emissions numbers relating to scope 1 emissions of greenhouse gas

- the total of any provisional emissions numbers that are attributable to the import, manufacture or supply of synthetic greenhouse gas

- the total of any provisional emissions numbers that are attributable to potential greenhouse gas emissions embodied in an amount of eligible upstream fuel

1.69 This information is published at the entity level and not at facility level. The *National Greenhouse and Energy Reporting Act 2007* will be amended so that sections 24 and 25 apply to Scheme entities as they currently only apply to constitutional corporations. ***[Schedule 1, Part 2, items 182-187]*** Of these amendments, item 184 will amend the *National Greenhouse and Energy Reporting Act 2007* as it stands after item 23 of the *National Greenhouse and Energy Reporting Amendment Act 2008* comes into force on 15 March 2009.

1.70 An amendment will be included to require the Authority to make the contents of the Register, established under section 16 of the *National Greenhouse and Energy Reporting Act 2007*, public subject to exceptions specified in the regulations. This is intended to give certainty regarding information to be published from the register. ***[Schedule 1, Part 2, item 174]***

1.71 Greenhouse gas emissions data that are obtained under the *National Greenhouse and Energy Reporting Act 2007* may currently be disclosed to specified persons or bodies as well as to States and Territories under sections 26 and 27. These sections will be extended to include data relating to Scheme entities, as they currently only apply to constitutional corporations. These proposed amendments have not yet been drafted.

Other general amendments

Object of the National Greenhouse and Energy Reporting Act 2007

1.72 One of the current objects of the *National Greenhouse and Energy Reporting Act 2007* is to underpin the introduction of an emissions trading scheme in the future. This object will be removed and replaced with an explicit reference to underpinning the main bill by imposing reporting requirements on liable entities under that bill. ***[Schedule 1, Part 2, items 98-101]***

Constitutional basis for the National Greenhouse and Energy Reporting Act 2007

1.73 Section 4 currently outlines the Commonwealth legislative powers upon which the *National Greenhouse and Energy Reporting Act 2007* is based. This will be amended to clarify that, to the extent to which

it supports the main bill, the *National Greenhouse and Energy Reporting Act 2007* relies on the same legislative powers that support the main bill. ***[Schedule 1, Part 2, items 102-104]***

Extension and limitation with regard to exclusion of some State and Territory laws

1.74 Section 5 of the *National Greenhouse and Energy Reporting Act 2007* provides for the exclusion of specific State or Territory laws (or a part thereof) applying to constitutional corporations if they provide for the reporting or disclosure of information relating to greenhouse gas emissions, greenhouse gas projects, energy consumption or energy production and are listed in the regulations as a law, or part of a law, to which the section applies.

1.75 The purpose of section 5 is to support the streamlining of greenhouse and energy reporting by enabling corporations to meet the reporting requirements of multiple programmes through a single framework, created under the *National Greenhouse and Energy Reporting Act 2007*.

1.76 No regulations have been made under this section to date and the Government is continuing to work cooperatively with State and Territory governments to transition towards a single reporting system across all jurisdictions.

1.77 Section 5 will be extended so that State or Territory laws providing for the reporting or disclosure of information related to greenhouse gas emissions can be excluded, by regulation, in relation to any person, not only constitutional corporations.

1.78 This provision will be limited so that it does not apply to a local governing body or a statutory authority of a State or Territory. ***[Schedule 1, Part 2, items 105-107]*** This limitation recognises that the Commonwealth does not wish to limit State and Territory laws (or a part thereof) from requiring reporting and disclosure of information related to greenhouse gas emissions by these entities to the States and Territories.

1.79 The Government will seek the views of States and Territories to ensure that laws not intended to be excluded by this bill will not be affected.

Crown to be bound

1.80 In line with usual practice, while the Crown is to be bound by the *National Greenhouse and Energy Reporting Act 2007*, the Crown is

not subject to a pecuniary or criminal penalty. ***[Schedule 1, Part 2, item 108]*** This protection does not apply to an authority of the Crown.

Territorial boundary

1.81 The territorial boundary and rights of foreign ships under the *National Greenhouse and Energy Reporting Act 2007* will be amended to align with the boundary and rights provided in the main bill. ***[Schedule 1, Part 2, item 109] [Schedule 1, Part 2, item 124] [Schedule 1, Part 2, items 145]***

Chapter 2

Taxation of emissions units

Outline of chapter

2.1 Schedule 2 of the draft Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009 amends the *Income Tax Assessment Act 1997* (ITAA 1997), the *Income Tax Assessment Act 1936* (ITAA 1936) and the *Taxation Administration Act 1953* (TAA 1953) to establish a rolling balance treatment of registered emissions units for income tax with the following main features:

- the cost of a unit is deductible, with the effect of the deduction being deferred through the rolling balance (in the standard case where banked units are valued at cost) until its sale or surrender
- the proceeds of selling a unit are assessable income
- any difference in the value of units held at the beginning of an income year and at the end of that year are reflected in taxable income, with:
  - any increase in value included in assessable income
  - any decrease in value allowed as a deduction.
- taxpayers can elect to value all units held at the end of the first income year they hold units at either cost or market value
- the choice of valuation method continues to apply but, as a transitional measure, can be changed once before the 2015-16 income year
- where an entity surrenders a unit for a purpose unrelated to producing assessable income, the deduction for the cost is effectively reversed by including in assessable income an amount equal to the amount deducted for its acquisition.

2.2 Schedule 2 also amends the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) to characterise a supply of an eligible emissions unit or a Kyoto unit as a supply of a personal property right(s) and not a supply of real property.

2.3 Legislative references in this chapter are to the ITAA 1997, except where indicated.

Context

Summary of how existing law would have applied

2.4 When the Carbon Pollution Reduction Scheme (the Scheme) commences, the proposed tax amendments apply immediately to set out the income tax treatment, and clarify the goods and services tax (GST) treatment, of Australian emissions units and certain other emissions units. The summary below outlines how the existing law would have applied to these emissions units, if the proposed tax amendments were not enacted.

Income tax

2.5 For a taxpayer carrying on a business or undertaking other assessable income earning activities, the existing income tax law would recognise the cost of acquiring units. The particular treatment and provisions that would apply in any particular case would depend on the taxpayer's activities and its purpose, both when purchasing the unit and while holding the unit. The Government's Green Paper discussed how the existing law would apply to an entity purchasing a unit for the following different purposes:

- to meet an obligation under the Australian scheme
- to surrender voluntarily as part of a marketing campaign
- as part of its trading portfolio

or

- for sale at a profit.

2.6 The Green Paper explained that in the first two cases the cost may be deductible but the timing of the deduction would be unclear. In the third case, where units were bought for trading, the cost would generally be deductible on acquisition but any change over an income year in the value of units held would be brought to account as a deduction (where the

value declined) or assessable income (where the value increased). In all three cases, any proceeds on the sale of the unit would be assessable income.

2.7 In the fourth case the cost would not be deductible or proceeds assessable but both would be taken into account in working out any assessable gain or deductible loss on the sale of a unit. In all cases, it would be very unlikely that a capital gain or loss would be recognised under the capital gains or losses (CGT) provisions.

2.8 A unit acquired for private or domestic purposes (for example, to be surrendered voluntarily to offset the carbon footprint of the purchaser's private residence) would not be deductible under the current tax law.

Goods and services tax

2.9 The supply of an eligible emissions unit or a Kyoto unit is a taxable supply if the requirements of section 9-5 of the GST Act are met.

2.10 GST applies to an eligible emissions unit or a Kyoto unit acquired from an entity outside Australia if the supply is connected with Australia and the other requirements of a taxable supply are met. If the supply of an eligible emissions unit or a Kyoto unit is not connected with Australia and the unit is acquired solely for a creditable purpose, GST does not apply.

2.11 The supply of an eligible emissions unit or a Kyoto unit to an entity outside Australia may be GST-free under an item in the table in subsection 38-190(1) of the GST Act if it is a supply other than of goods or real property. To satisfy certain items in the table it is a requirement that the supply of the eligible emissions unit or Kyoto unit is not a supply directly connected with real property. Additionally, to satisfy item 4 of the table in subsection 38-190(1) of the GST Act, it must be the supply of a right.

The Government's Green and White papers

Objectives of the tax treatment of units

2.12 The Green and White papers explained that the tax treatment of units aims to:

- ensure the tax treatment of units does not compromise the scheme's main aim of cost effectively meeting Australia's emissions reduction targets and contributing to the development of an effective global response to climate change

- incorporate the tax axioms of simplicity, efficiency and equity.

Income tax

2.13 To prevent complexities and uncertainties that would result from applying the existing income tax law to emissions units, the Government's preferred position in the Green Paper was to develop discrete income tax provisions for units. Those provisions would establish a rolling balance treatment, similar to the trading stock provisions, under which.

- the cost of a unit would be deductible when the unit is acquired
- the proceeds from selling a unit would be assessable income
- any difference in the value of units held at the beginning of an income year and at the end of that year would be reflected in taxable income, with any increase in value included as assessable income and any decrease in value allowed as a deduction.

2.14 The White Paper set out the Government's decision that the rolling balance treatment should apply to units and further details as to how the rolling balance would operate.

Goods and services tax

2.15 The Government's preferred position in the Green Paper was that normal GST rules would apply to scheme transactions. This would ensure that scheme transactions would receive the same treatment as similar transactions in the broader economy. It would be consistent with the underlying principles of the GST, including its broad-based nature, while also minimising compliance costs and avoiding complexity in the law. The treatment of eligible emissions units or Kyoto units under the normal rules would generally not lead to embedded GST for GST registered entities.

2.16 The White Paper stated that the normal GST rules would apply to scheme transactions. The White Paper also stated that to promote certainty, the Government would amend the GST law to characterise eligible emissions units and Kyoto units as personal property rights and that the units would not be real property for the purposes of the GST Act.

Summary of new law

2.17 Schedule 2 of the draft Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2008 establishes the income tax treatment, and clarifies the goods and services tax (GST) treatment, of emissions units.

Income tax

2.18 As proposed in the Green and White papers, the Bill introduces discrete provisions that establish a rolling balance method of accounting for registered emissions units, similar to that for trading stock. The main features are:

- the cost of a unit is deductible, with the effect of the deduction being deferred through the rolling balance (in the default case where banked units are valued at cost) until its sale or surrender
- the proceeds of selling a unit are assessable income
- any difference in the value of units held by a taxpayer at the beginning of an income year and at the end of that year are reflected in taxable income, with:
  - any increase in value included in assessable income
  - any decrease in value allowed as a deduction;
- the basic rule is that taxpayers value all the units held at the end of an income year at cost. However the taxpayer can elect to value all units held at the end of an income year at market value
- a taxpayer's choice of valuation method continues to apply; however a taxpayer will be able to change valuation methods once during a transitional period of five years from the scheme's commencement, after which no change will be allowed
- free Australian emissions units held at the end of an income year are generally taken to have a cost equal to their market value at the date of issue
- where an entity surrenders a unit for a purpose unrelated to producing assessable income, the deduction for the cost of

the unit is effectively reversed by including in assessable income an amount equal to the amount deducted.

Goods and services tax

2.19 The supply of an eligible emissions unit or a Kyoto unit is the supply of a personal property right(s). An eligible emissions unit or a Kyoto unit is excluded from the definition of real property in the GST Act. Further, the supply of an eligible emissions unit or a Kyoto unit is taken not to be a supply directly connected with real property for the purposes of the table in subsection 38-190(1) of the GST Act.

Detailed explanation of new law

Income tax

2.20 The income tax treatment of emissions units under the Carbon Pollution Reduction Scheme centres on the registration of units on the National Registry of Emissions Units (the National Registry). The treatment of emissions units can be divided into what happens to an entity's account on the National Registry when the entity:

- becomes the holder of a registered emissions unit during an income year
- holds a registered emissions unit at the end of an income year

or

- ceases to hold a registered emissions unit during an income year by:
  - surrendering it, in which case the unit is removed from the National Registry (section 129 of the Carbon Pollution Reduction Scheme Bill 2009 (the Main Bill)
  - disposing of it, in which case the unit is transferred to a registered account held by another entity on the National Registry (for example, under sections 94 & 95 of the Main Bill)
  - transferring the unit to the entity's own foreign account, upon which it ceases to be a registered emissions unit (sections 109 and 120 of the Main Bill)

or

– relinquishing it, in which case the unit is cancelled or transferred to the Commonwealth (section 286 of the Main Bill).

Meaning of registered emissions unit

2.21 ***Registered emissions unit*** is a defined term that is intended to cover those units that are actually registered on the National Registry. An emissions unit is a registered emissions unit if:

- the unit is an eligible emissions unit or a Kyoto unit; and
- there is an entry in a National Registry account for the unit. ***[Schedule 2, item 19, section 420- 10 and item 46, definition* registered emissions unit*, subsection 995-1(1)]***

2.22 The terms ***eligible emissions unit***, ***Kyoto unit*** and ***Registry account*** all have the same meanings that they have in the Main Bill. An eligible emissions unit is one that an entity can surrender to prevent a unit shortfall. Some types of Kyoto units (an assigned amount unit and a certified emission reduction derived from an afforestation or reforestation project) cannot be surrendered to prevent a unit shortfall but nevertheless they can be registered on the Australian Registry.

Holding a registered emissions unit

2.23 For the income tax law, an entity ***holds*** a registered emissions unit if they are the registered holder of the unit within the meaning of the Main Bill. ***[Schedule 2, item 19, section 420-12]***

Registered emissions units held by a person as a nominee

2.24 There is a specific 'look–through' rule that clarifies the income tax treatment where the registered holder of a registered emissions unit is holding the unit as a mere nominee for another entity. The other entity is treated as holding the unit and the registered holder is treated as not holding the unit. ***[Schedule 2, item 19, subsection 420-12(2)]***

2.25 Nominee has its ordinary meaning in the ITAA 1997, which in this context is someone who holds bare legal title for the benefit of another (Black's Law Dictionary, 8th edition).

Example 2.1

Z is a stock broker who acquires and holds 50,000 Australian emissions units in a National Registry account. Z acquired and holds those units on behalf of its client, Company B.

The 'look-through' rule applies for income tax because Z holds the units as nominee for Company B. Company B is treated as holding the 10,000 Australian emissions units, which are registered emissions units, and Z is treated as not holding those units.

Example 2.2

A holds 10,000 Australian emissions units in a National Registry account. A is the managing partner of a partnership, which carries on a business of trading in emissions units and other personal property. A acquired and holds the units on behalf of all the partners.

The 'look-through rule' applies for income tax because A holds the units as nominee for the partnership. The partnership is treated as holding the 10,000 Australian emissions units, which are registered emissions units, and A is treated as not holding those units.

Example 2.3

T is the trustee of a discretionary trust. Acting as trustee, T acquires and holds 10,000 Australian emissions units in a National Registry account.

The 'look-through' rule for nominees does not apply because T is not a mere nominee. The units are held by the trust for income tax purposes. Under the Main Bill, Australian emissions units are held in a National Registry account kept by a person. Person is defined to include a trust, which in turn is defined to mean a person in the capacity as trustee or, as the case requires, a trust estate. Both meanings of trust under the Main Bill are consistent with treating the unit as held by the trust for the purpose of working out income tax liabilities.

Becoming the holder of a registered emissions unit

2.26 An entity becomes the holder of a registered emissions unit during an income year by:

- purchasing a registered emissions unit:
  - at an original auction conducted by the Authority for the Commonwealth (section 99 of the Main Bill)
  - on the secondary market, including at a secondary market auction (section 101 of the Main Bill)

– as part of the fixed price cap arrangement (section 89 of the Main Bill)

or

– operation of law (section 97 of the Main Bill).

- being issued a free registered emissions unit by reason of:

  – passing an EITE activities eligibility test (Part 8 of the Main Bill)

  or

  – being a coal-fired electricity generator (Part 9 of the Main Bill).

- being issued a free registered emissions unit by reason of certain activities undertaken by the entity:

  – sequestering carbon in a Kyoto compliant forest (Part 10 of the Main Bill)

  or

  – destroying synthetic greenhouse gases (Part 11 of the Main Bill).

- transferring an international emissions unit from a foreign account onto the National Registry (section 110 or section 121 of the Main Bill).

Deductions for expenditure in obtaining a unit

2.27 An entity can deduct expenditure to the extent that the entity incurs it in becoming the holder of a registered emissions unit. The expenditure is deductible in the year the entity starts to hold the unit, ensuring that the timing of the deduction is matched to the income year in which the unit enters the entity's rolling balance account. ***[Schedule 2, item 19, section 420- 15].***

2.28 However, there are exceptions. Expenditure incurred in becoming the holder is not deductible under the proposed provisions in Divisions 420 if the registered emissions unit is issued in accordance with:

- the emissions-intensive trade-exposed assistance program ***[Schedule 2, item 19, paragraph 420- 15(3)(a)]***

- coal-fired electricity generation assistance ***[Schedule 2, item 19, paragraph 420- 15(3)(b)]***

- carbon sequestration by reforestation ***[Schedule 2, item 19, subsection 420- 15(4)]***

or

- the destruction of synthetic greenhouse gases ***[Schedule 2, item 19, subsection 420- 15(5)]***.

2.29 Expenditure excluded from deduction under Division 420 may nevertheless be deductible under the other provisions of the income tax law. Where an entity is undertaking forestry sequestration or the destruction of synthetic greenhouse gases, the normal deduction provisions apply to work out the deductibility of the expenses they incur in those activities. The activities are effectively regarded as directed towards producing trees or destroying synthetic greenhouse gases (and any assessable income flowing from those activities), rather than towards producing units. If Division 420 were applied in these cases, various deductions would potentially be deferred until the units produced started to be held. ***[Schedule 2, item 19, subsections 420- 15(4) and (5)]***

2.30 Expenditure incurred in preparing or lodging a reforestation report, an application for a certificate of reforestation or an application for a certificate of eligible greenhouse gas destruction, can be deducted under Division 420 (where the relevant conditions are satisfied). That expenditure is directly related to the production of Australian emissions units. ***[Schedule 2, item 19, subsection 420- 15(4) and (5)]***

Example 2.4

A registered reforestation entity engages an expert to assist in submitting a reforestation report and applying for a certificate of reforestation. The expert recommended purchase of a specialised computer program for preparation of such reports and the entity made the purchase of this software. The amount paid to the expert so far as this is for preparation of the reforestation report and of the application for a certificate of reforestation is deductible under subsection 420-15(4). The amount paid for the software so far as this is acquired for preparation of such reports is also deductible under this subsection.

2.31 Expenditure incurred in becoming the holder of a registered emissions unit is also not deductible where, if the unit were sold, the proceeds would not be assessable income. This is designed to prevent foreign residents who are not assessable on the proceeds of sale of units from obtaining a deduction which could be offset against other Australian assessable income. ***[Schedule 2, item 19, subsection 420- 15(6)]***

Non-arm's length transactions and transactions with associates

2.32 Non-arm's length transactions and transactions with associates where the consideration provided and received are not equal to the market value are taken to have been at market value. That is, market value consideration is taken to have been incurred and derived whether the actual consideration was less than, or greater than, market value. ***[Schedule 2, item 19, subsection 420-20(1)]***

2.33 There are a number of carve outs from this general principle. The principle does not apply to the issue of Australian emissions units under the CPRS. Australian emissions units issued via auctions will by their nature be issued at the market value and so do not need to be covered by the principle. The treatment of recipients of free Australian emissions units is specifically dealt with elsewhere in the Division. The recipients are not taken to have provided any consideration. The other broad category of Australian emissions units that are issued are the created units that arise from the sequestration of carbon in Kyoto-compliant forests or the destruction of synthetic greenhouse gases. ***[Schedule 2, item 19, subsection 420-20(3)]***

2.34 Another category of transaction that is carved out from the non-arm's length transactions and transactions with associates principle is the transmission of emissions units arising from the death of individuals who held them just before their death, whether to a legal personal representative or to a beneficiary in the estate. ***[Schedule 2, item 19, subsection 420-20(2)]***

Relationship with international transfer pricing provisions

2.35 Section 136AB of the ITAA 1936 is amended to clarify the relationship between the proposed non-arm's length transaction section (section 420-20) and the international transfer pricing provisions in Division 13 of the ITAA 1936. In any case where either section 420-20 or Division 13 could otherwise apply, the potential operation of section 420-20 is to be disregarded. This leaves Division 13 to apply comprehensively in the international area, subject to the terms of any relevant double tax treaty. ***[Schedule 2, item 7, subsection 136AB(2) of the ITAA 1936]***

2.36 The result is that the relationship of section 420-20 with Division 13 is the same as that of section 70-20, the non-arm's length rule for trading stock.

Transfer of an international emissions unit from a foreign registry to the Australian National Registry

2.37 An entity may transfer an international emissions unit from a foreign registry to its account on the Australian National Registry. The

process for this is set out in Part 4 of the Main Bill and it is commonly called importing an emissions unit.

2.38 An ***international emissions unit*** is defined in the Dictionary to the ITAA 1997 to mean a Kyoto unit or non-Kyoto international emissions unit, both of which have the same meaning as they have in the Main Bill. ***[Schedule 2, item 45, subsection 995-1(1)]***

2.39 Division 420 provides specific rules for registered emissions units once they become registered on the National Registry. The general income tax provisions apply to international emissions units until the time the units are registered on the National Registry and become subject to Division 420 treatment (that is, when they are transferred from your foreign account). On entry to the National Registry, an international emissions unit is recorded at its market value. It is treated as if it was sold for market value to someone else, and repurchased for the same amount, just before it was entered on the National Registry. This ensures that any gain or loss that accrued before the unit was registered is brought to account under the provisions that applied before registration and any gain or loss while the unit is registered is treated under Division 420.

2.40 For income tax, the entity that transfers the unit from its foreign account to its National Registry account is treated as having sold the unit to someone else for its market value just before it became a registered emissions unit. The entity is also treated as having immediately bought it back as a registered emissions unit for the same amount. ***[Schedule 2, item 19, section 420-30]***

Example 2.5

An Australian resident company carries on a large manufacturing business in Australia. The company holds 100,000 emission reduction units (a type of international emissions unit) that are registered in New Zealand. The company then transfers all those emission reduction units from the New Zealand Register to its Australian National Registry account and immediately after that surrenders them to acquit an Australian emissions liability.

The company is treated as having sold each unit to someone else at its market value just before it became the holder of a registered emissions unit in Australia. The treatment under the general income tax law of the proceeds of selling emission units is discussed in detail in the Green Paper at 11.3 and is summarised after this example.

The company is also treated as having bought 100,000 registered emissions units for the same amount. The company is entitled to a deduction for that amount (section 420-15).

2.41 Before they became registered emissions units in Australia, the emissions units would generally be dealt with on revenue account (the cost and proceeds would be directly deductible and assessable or taken into account in working out assessable profits or deductible losses – see Green Paper at 11.3). However, if an emissions unit were not a revenue asset in a particular case, a capital gain or loss on its deemed disposal would be brought to account.

2.42 The proposed treatment as a sale for market value and as a repurchase for market value applies across the income tax law – it is not just for the purposes of Division 420. The capital gains and losses provisions are also amended because the CGT events generally do not rely on deemed sales or disposals. When a taxpayer starts to hold as a registered emissions unit, an international emissions unit they already held, a CGT event happens. This is done by inserting a new CGT event K1, which expressly provides that the entity can make a capital gain or capital loss when they start to hold an international emissions unit as a registered emissions unit. ***[Schedule 2, items 14 and 15, sections 104-5 and 104-205]***

2.43 Where an emissions unit transferred to the National Registry was held as trading stock just before the transfer, the Division 420 rules apply rather than the trading stock rules that deal with a taxpayer ceasing to hold an item as trading stock but still owning it. ***[Schedule 2, items 12 and 13, section 70-110(2)]***

Ceasing to hold a registered emissions unit

2.44 An entity ceases to hold a registered emissions unit during an income year by:

- transferring it to either another account holder on the National Registry (for example, under paragraph 95(a) of the Main Bill) or to another account holder on the Registry of another country (for example, under paragraph 109(1)(c) of the Main Bill)

- surrendering it to the Authority, upon which the registration is cancelled or the unit is removed from the entity's National Registry account (under section 129 of the Main Bill)

- transferring it from their account on the National Registry to their account on the Registry of another country (for example, under paragraph 109(1)(d) of the Main Bill)

or

- relinquishing it, in which case the unit is cancelled or transferred to the Commonwealth relinquished units account (under section 286 of the Main Bill).

2.45 An entity's assessable income includes an amount the entity is entitled to receive because they disposed of a registered emissions unit. The amount is assessable income in the income year they cease to hold the unit, ensuring that the timing of assessability is matched to the income year in which the unit leaves the entity's rolling balance account. That amount is also taken to have a source in Australia. ***[Schedule 2, item 19, section 420-25]***

Transfer of an international emissions unit from the National Registry to a foreign registry

2.46 An entity may transfer an international emissions unit from the National Registry to its own account on a foreign registry. The process for this is set out in Part 4 of the Main Bill and is commonly called exporting an emissions unit.

2.47 The income tax treatment under Division 420 ceases when the emissions unit ceases to be registered in Australia on the National Registry. The unit thus ceases to be held as a registered emissions unit. After that, the emissions unit is treated under the general income tax law. Similarly to the importation of a unit, the termination of the Division 420 treatment and the commencement of the new treatment are both based on market value at de-registration. Any gain or loss while the unit is registered in Australia is treated under Division 420. Any gain or loss after Australian registration on the National Registry ceases is brought to account under the general provisions of the income tax law.

2.48 To achieve this result for income tax, the entity that transfers the unit is treated as having sold the unit to someone else for its market value just before it ceased to be a registered emissions unit. The entity is also treated as having immediately bought it back as an emissions unit that is not a registered emissions unit in Australia for the same amount. ***[Schedule 2, item 19, section 420-35]***

2.49 Where the entity that transfers a registered emissions unit from the Australian Registry to its account on a foreign registry holds the unit as trading stock just after the transfer, the Division 420 rules apply rather than the trading stock rules that deal with a taxpayer starting to hold as trading stock an item they already own. ***[Schedule 2, item 11, subsection 70-30(6)]***

Example 2.6

An Australian resident company carries on a business of trading in emissions units. The company owns 10,000 emission reduction units (a

type of an international emissions unit) that are registered in Australia. 5,000 of those units are transferred from the Australian National Registry to its foreign account on the New Zealand Register.

The company is treated as having sold each unit to someone else at its market value just before it stopped holding the unit as a registered emissions unit. As the unit was a registered emissions unit, the market value is included in the company's assessable income (section 420-25).

The company is also treated as having bought 5,000 emission reduction units for the same amount. The company may be able to deduct that amount under section 8-1 and, assuming the units became trading stock of the company, normally would be able to do so (subject to other special provisions that might deny a deduction).

2.50 The proposed treatment applies across the income tax law – it is not just for the purposes of Division 420. After an international emissions unit ceases to be a registered emissions unit in Australia, it would normally be dealt with on revenue account (the cost and proceeds would be directly deductible and assessable or taken into account in working out assessable profits or deductible losses – see Green Paper at 11.3). However, if it were not a revenue asset in a particular case, a capital gain or loss on its eventual disposal would be brought to account.

2.51 The deemed acquisition of the emissions unit is an acquisition of a CGT asset for the capital gains and losses provisions. The capital gains and losses provisions are amended to clarify how to work out the cost base of a unit that is deemed to be acquired. The first element of the cost base (what the taxpayer paid for the unit) is the market value just before the unit stopped being a registered emissions unit. ***[Schedule 2, item 16, section 112-97]***

Disposal for a purpose other than gaining assessable income

2.52 Where an entity ceases to hold a registered emissions unit and that cessation is unrelated to gaining assessable income, there is a claw-back of any amount that the entity has deducted or can deduct for expenditure incurred in acquiring the unit. ***[Schedule 2, item 19, subsection 420-40(1)]***

2.53 This claw-back provision tests for a purpose unrelated to producing assessable income (for example, a private or domestic purpose) at the time of disposal of a unit, rather than at acquisition. The proposed approach has been adopted because of the evidentiary difficulty of determining the purpose of acquiring a unit and because it avoids complexities where a purpose changes before disposal. ***[Schedule 2, item 19, subsection 420-40(1)]***

2.54 The test of a purpose unrelated to producing assessable income is based on the general deduction provision, section 8-1. It is whether the cessation is neither:

- in gaining or producing an entity's assessable income

nor

- in carrying on a business for the purpose of gaining or producing assessable income. ***[Schedule 2, item 19, subsection 420-40(1)]***

2.55 A business entity that surrenders units (beyond any potential emissions liability) for promotional or marketing purposes would not satisfy this test and the claw–back would not apply. In contrast, an individual who surrenders units to offset the carbon footprint of their private residence would satisfy the test and the clawback would apply (assuming other conditions were met). ***[Schedule 2, item 19, subsection 420-40(1)]***

2.56 The claw-back operates by including in assessable income, for the income year in which the cessation occurred, an amount equal to the amount that the entity can deduct or has deducted. This claw-back method is used rather than denying the original deduction because it avoids the compliance and administration costs of re-opening assessments for previous income years. ***[Schedule 2, item 19, subsection 420-40(1)]***

2.57 If the entity ceases to hold the unit as a result of a non-arm's length transaction to which section 420-20 applies, section 420-20 applies instead of the claw-back section. ***[Schedule 2, item 19, subsection 420-40(1)]***

2.58 Where the cessation is because of the death of an individual and the unit passes to the deceased's legal personal representative or (directly or indirectly) to a beneficiary of the deceased's estate, there is essentially a "roll-over" treatment. The acquirer is treated as acquiring the unit for the amount included in the transferor's assessable income under the claw-back provision, which is equal to any amounts deducted or deductible for expenditure incurred in acquiring it (basically its cost). A legal personal representative who passes the unit to a beneficiary is also treated as disposing of the unit for the same amount. ***[Schedule 2, item 19, subsections 420-40(2) and (3)]***

2.59 Where the cessation is for a purpose unrelated to producing assessable income and is not because of death, the acquirer is also treated as acquiring the unit for the amount included in the transferor's assessable income under the claw-back provision. ***[Schedule 2, item 19, subsection 420-40(4)]***

Accounting for registered emissions units held at the start or end of the income year

2.60 A key feature of the rolling balance treatment is that a taxpayer must bring to account any difference between the value of the registered emissions units they held at the start and the value of the registered emissions units they held at the end of the income year. ***[Schedule 2, item 19, subsection 420-45(1)]***

2.61 Any excess of the value at the end of the income year over the value at the start of the income year is included in the taxpayer's assessable income. ***[Schedule 2, item 19, subsection 420-45(2)]***

2.62 Any excess of the value at the start of the income year over the value at the end of the income year is deductible. ***[Schedule 2, item 19, subsection 420-45(3)]***

2.63 The effect of this tax accounting is that:

- the value of a taxpayer's registered emissions units held at the end of an income year increases their taxable income
- the taxpayer's taxable income for the next income year is reduced by the same value.

Value of registered emission units at the start of the income year

2.64 The ***value*** of a registered emissions unit held by a taxpayer at the start of an income year is defined to be the same amount at which it was taken into account under the registered emission provisions at the end of the last income year. If the unit was not taken into account under this Subdivision at the end of the last income year (for example, due to an error by the taxpayer in completing their income tax return that can no longer be corrected) the ***value*** of the unit is a nil amount. ***[Schedule 2, item 19, section 420-50]***

Value of registered emissions units at the end of the income year

2.65 A taxpayer has a choice between two methods – cost and market value - in valuing the registered emissions units it holds at the end of an income year. The taxpayer makes the choice for the first income year where it holds registered emissions units at the end of the income year. This choice allows taxpayers to select the method that best suits their business practices. ***[Schedule 2, item 19, subsection 420-55(1)-(3)]***

2.66 A choice must be made before a taxpayer lodges their income tax return for the income year for which they can make a choice. The choice

is made by applying the chosen method in the income tax return that is lodged. A choice is irrevocable for the income year for which it is made. ***[Schedule 2, item 19, subsection 420-55(4)-(6) and 420-56(3)-(5)]***

2.67 If the taxpayer fails to make a choice the default valuation method is the cost of the units. Default choice rules like this are commonly included in the income tax law to prevent a possible problem in assessing a taxpayer that fails to make a choice. The default valuation method of historical cost is the method that most taxpayers are likely to choose. Under the historical cost method, unrealised gains are not assessed and unrealised losses are not deducted. ***[Schedule 2, item 19, subsection 420-55(1) and (6)]***

2.68 A taxpayer's choice continues to apply for later income years. However, a taxpayer will be able to change their choice of valuation method once during a transitional period ending with the 2014-15 income year. This will give them the opportunity to consider changing valuation methods in the period after the first Kyoto Protocol commitment period ends in 2012, should circumstances change. If a taxpayer changes methods it must value any units it holds at the end of a later income year according to the same method. ***[Schedule 2, item 19, section 420-56]***

Example 2.7

Company A first holds registered emissions units at the end of the 2010-11 income year. It chooses to value those units at cost under Subdivision 420-D. For the 2011-12 & 2012-13 income years, it continues to value the units it holds at the end of the income year at cost. For the 2013-14 income year it chooses to value the units it holds at the end of the income year at market value. For each later income year the company must value all the units it holds at market value. The company is only permitted to make one change in valuation method (and that must be during the transitional period ending with the 2014-15 income year).

2.69 After the 2014-15 income year, a taxpayer will not be able to change its choice of methods. Allowing ongoing change of choice would create opportunities for tax arbitrage (that is, the exploitation of differences in the historical cost and market value of units in order to reduce tax liabilities) from year to year. It would also increase compliance costs for taxpayers and administrative costs for the Australian Tax Office. ***[Schedule 2, item 19, sections 420-55 and 420-56]***

Example 2.8

The 2016-17 income year is the first income year for which Company B holds registered emissions units at the end of the income year. It chooses to value those units at cost under Subdivision 420-D. For each later income year the company must value all the units it holds at cost.

No change in valuation methods is permitted after the transitional period ending with the 2014-15 income year.

Cost of a registered emissions unit

2.70 The ***cost*** of a registered emissions unit is a defined term. Cost generally has its ordinary meaning but that ordinary meaning is specifically modified in the circumstances explained below. ***[Schedule 2, item 42, subsection 995-1(1), item 19, 420-60]***

2.71 In this context, the ordinary meaning of cost would not be limited to the price paid for a unit but would also cover transaction costs (for example, a brokerage fee) incurred in becoming the holder of a registered emissions unit.

First-in, first-out rule

2.72 Registered emissions units are essentially fungible in that, for a particular vintage, one unit can replace another. A 'first-in, first-out' rule is proposed to limit possible distortions in taxpayers' decisions about holding or surrendering particular units. Cases where decision-making might otherwise be distorted include where units acquired earlier have a significantly lower cost than more recently acquired units and where free units held by an emissions-intensive trade-exposed entity have a zero cost.

2.73 First–in first-out is a rule that is commonly used in determining the cost of fungible items. For example, it is one method acceptable in working out the cost of fungible items of trading stock under the income tax law.

2.74 In working out the cost of a unit for income tax purposes taxpayers must apply the 'first-in, first-out' rule for units of the same vintage. The rule is used to determine which units are sold or surrendered and which are still held. Units of the same vintage are treated as being disposed of in the same order as they are acquired. ***[Schedule 2, item 19, sections 420-55(7) and 420-56(8)]***

2.75 The rule does not apply beyond income tax. For example, the rule does not affect the operation of the Registry accounts in the National Registry of Emissions Units. ***[Schedule 2, item 19, sections 420-55(7) and 420-56(6)]***

Cost of free units issued other than under the emissions-intensive trade-exposed industries program

2.76 If the Authority issues a unit free of charge to a taxpayer under the Main Bill and that taxpayer still holds that unit at the end of an income

year, the general rule is that the cost of the unit is its market value just after the taxpayer began to hold it. This reflects what it would have cost the taxpayer to buy a unit at that time and, therefore, provides a neutral treatment between free units and purchased units which does not distort a taxpayer's choice to surrender or sell the free unit. It is also consistent with the ordinary treatment of Government assistance received by a taxpayer in the course of carrying on its business, which is that the amount is assessable income in the year it is derived (for ordinary income) or received (for statutory income).

2.77 There is an exception in limited circumstances where a taxpayer holds units at the end of an income year that were issued free of charge to the taxpayer under the emissions-intensive trade-exposed industries program (see below under 'Valuation of free units issued under the emissions-intensive trade-exposed industries program').

Market value of a registered emissions unit

2.78 Market value is a defined term in the ITAA 1997. Market value generally has its ordinary meaning but that ordinary meaning is affected by Subdivision 960-S.

2.79 Valuation of free units issued under the emissions-intensive trade-exposed industries program is described above. Where those units are valued at nil under a 'no-disadvantage rule', the units have a nil value at year end regardless of whether the taxpayer uses the cost or market valuation methods for all their units on hand. ***[Schedule 2, item 19, subsections 420-57(2)]***

2.80 Where the taxpayer sells a free unit before the end of the income year the proceeds of sale are assessable income, as explained above under 'Ceasing to hold a registered emissions unit'.

Valuation of free units issued under the emissions-intensive trade-exposed industries program

2.81 A free unit issued to an entity in accordance with the emissions-intensive trade-exposed industries program is valued at zero in specified circumstances. This valuation rule was referred to in the White Paper as a 'no–disadvantage rule'. For the rule to apply, all of the following conditions must be satisfied:

- the entity holds the unit at the end of the relevant income year
- the entity held the unit at all times from when the Authority issued it to the entity until the end of that income year

- the relevant income year ends on or before the last day for surrendering units for the financial year of that particular vintage – which will be on 15 December after the end of the vintage year. ***[Schedule 2, item 19, subsections 420-57]***

2.82 This no-disadvantage rule is designed to minimise any timing disadvantage that an entity in an emissions-intensive trade-exposed industry might arguably suffer by bringing to account the value of the free unit as income during the no-disadvantage period where it receives a free unit and still holds it in the circumstances described.

2.83 The valuation at zero under this 'no-disadvantage rule' applies and the units have a nil value at year end regardless of whether the taxpayer has chosen to value all the units it holds under the cost or market valuation methods. ***[Schedule 2, item 19, subsections 420-57(2)]***

2.84 Where an entity holds a free unit at the end of an income year that ends after the period during which the no disadvantage rule applies, the free unit is valued at cost or market value depending on the choice that the taxpayer makes. Cost is considered to be the market value at the date of its issue, in accordance with the general rule for valuing at cost units issued free of charge. ***[Schedule 2, item 19, subsections 420-60]***

2.85 Emissions-intensive trade-exposed industries are different from coal-fired electricity generators as they compete on the world market. The aim of the annual assistance is to minimise the impact of the scheme on EITE entities' decisions on whether to continue to produce in Australia. Coal-fired electricity generators are being provided with transitional assistance which is not expected to influence their production decisions. Free units issued to coal-fired electricity generators, if held at the end of the income year, are included in assessable income for that year, consistent with the approach to taxing industry assistance generally (see discussion above under 'Cost of free units issued other than under the emissions-intensive trade-exposed industries program'.

Example 2.9

In August 2011 the Authority issues 1 million free Australian emissions units with a 2011-12 vintage to an EITE entity. The market value of a unit at issue (as per the secondary market) is $21.

In October 2011 the entity sells 400,000 of the free Australian emissions units for $22 each. The entity has an emissions liability for the 2011-12 emissions year and surrenders 400,000 units in June 2012 and a further 100,000 in December 2012 to avoid a unit shortfall penalty (for not surrendering sufficient units by the due date, 15 December 2012).

The entity sells the remaining 100,000 units in July 2013 for $25 each.

For income tax, the entity has a standard income year ended 30 June and has chosen to value all units held at the end of an income year at cost.

For simplicity purposes this example concentrates on the group of free Australian emissions units with a 2011-12 vintage and ignores any other units acquired, held or surrendered by the entity.

Income tax treatment

Income year ended 30 June 2012: the proceeds of selling units (400,000 @ $22 = $8.8 million) are assessable income. The surrender of units has no effect on taxable income because none of the units were held at the start of the income year and no amount is included in assessable income. The remaining 200,000 units held at year end are valued at zero in the rolling balance under the no-disadvantage rule. The net effect on taxable income is an increase of $8.8 million.

Income year ended 30 June 2013: The surrender of units has no effect on taxable income because the opening balance is zero and no amount is included in assessable income. At year end the no-disadvantage period has finished because the last surrender date for the 2011-12 emissions year (15 December 2012) has passed. Consequently, the remaining 100,000 units held at year end are valued in the rolling balance at their deemed cost, the market value at the date of issue (100,000 @ $21 = $2.1 million). The net effect on taxable income is an increase of $2.1 million.

Income year ended 30 June 2014: the proceeds of selling units (100,000 @ $25 = $2.5 million) are assessable income. The entity deducts the decline in the value of units held in the rolling balance (100,000 @ $21 = $2.1 million). Therefore, the net effect on taxable income is an increase of $400,000.

Interactions of emissions units provisions with the rest of the income tax law

Anti-overlap rules

2.86 Generally, Division 420 has priority over the rest of the income tax law in working out the income tax treatment of the acquisition, holding and disposing of units. Subdivision 420-E contains detailed rules to give effect to this object and sets out exceptions to the general primacy of Division 420. Those detailed rules specifically cover:

- expenditure an entity incurs in becoming the holder of registered emissions unit ***[Schedule 2, item 19, section 420-65]***

- an amount an entity is entitled to receive because it ceases to hold a registered emissions unit ***[Schedule 2, item 19, section 420-70]***.

2.87 Expenditure incurred in becoming the holder of a registered emissions unit is generally deducted under Division 420 and not under the other provisions of the income tax law. Nor is that expenditure taken into account in working out the amount of a net profit or loss that is assessable or deductible respectively outside Division 420. However, for expenditure relating to acquiring free Australian emissions units there are special rules that are discussed below. ***[Schedule 2, item 19, subsections 420-65(1) and (2)]***

2.88 The assessability of an amount that an entity is entitled to receive because it ceases to hold a registered emissions unit is considered primarily under Division 420 and not under other provisions of the income tax law. Nor is the amount receivable taken into account in working out the amount of a net profit or loss that is assessable or deductible respectively outside Division 420. This does not affect the operation of the residence and source rules in sections 6-5 and 6-10, which are central assessable income provisions that all amounts of ordinary and statutory income must satisfy to be assessable income. ***[Schedule 2, item 19, subsections 420-70(1) and (2)]***

2.89 Division 420 also has priority in the treatment of free Australian emissions units. Contrary to the normal treatment, the value of free units received is not assessed as ordinary income or as a bounty or subsidy received in relation to carrying on a business (under section 15-10). Rather, the value of any free units held at the end of an income year is taken into account (under Subdivision 420-D) in working out any change in the value of units held over the income year. ***[Schedule 2, item 19, subsection 420-70(3)]***

Forestry sequestration and destroying synthetic greenhouse gases

2.90 As discussed above under 'Deductions for expenditure in obtaining a unit', expenditure incurred in forestry sequestration activities or in destroying synthetic greenhouse gases is not deducted under Division 420. Those expenditures will continue to be deducted under the provisions that ordinarily apply to those activities, for example, the general deduction provision (section 8-1) and capital allowance provisions (Division 40). Consequently, Division 420 does not change the timing of the write-off of forestry expenditure or expenditure in destroying synthetic greenhouse gases. ***[Schedule 2, item 19, subsections 420-15(4) and (5))]***

Free Australian emissions units issued under the emissions-intensive trade-exposed assistance program and to coal-fired electricity generators

2.91 Free Australian emissions units issued under the emissions-intensive trade-exposed assistance program and to coal-fired electricity generators are essentially Government assistance and not the result of expenditure by the entity receiving free units. Any expenditure that might be considered to be incurred in becoming the holder of these units is considered under the ordinary deduction provisions and not under Division 420. ***[Schedule 2, item 19, subsection 420-15(3))]***

Gifts

2.92 Whether a taxpayer is entitled to a deduction for a gift of a registered emissions unit to a deductible gift recipient is determined under the rules about deductions for gifts in Division 30. ***[Schedule 2, item 19, subsection 420-65(5)]***

Capital gains and losses

2.93 Consistent with the priority given to Division 420, any capital gain or capital loss that a taxpayer makes from a registered emissions unit or from the right to a free Australian emissions unit is disregarded. ***[Schedule 2, item 17, section 118-15]***

Trading stock

2.94 To make it completely clear that the trading stock provisions do not apply to registered emissions units (even where they might otherwise be trading stock), registered emissions units are expressly excluded from the definition of ***trading stock***. ***[Schedule 2, items 10 and 47, section 70-12 and subsection 995-1(1)]***

Taxation of financial arrangements

2.95 Under the Tax Laws Amendment (Taxation of Financial Arrangement) Bill 2008, currently before Parliament, proposed Division 230 defines 'financial arrangement' and sets out the methods under which gains and losses from financial arrangements will be brought to account for income tax purposes.

2.96 The White Paper set out the Government's intention that proposed Division 230 will not apply to the acquisition, holding and disposal of registered emissions units. To avoid any doubt as to whether a registered emissions unit is a financial arrangement, proposed Division 230 is amended so that it does not apply to a gain or loss made from a registered emissions unit. ***[Schedule 2, item 18, section 230-481]***

2.97 Proposed Division 230 may apply to derivatives of registered emissions units (for example, an option in relation to a unit) where the derivatives satisfy the relevant conditions (including relevant thresholds for the entity that has the derivative). As derivatives of units are one of many types of derivatives, the normal rules that apply to derivatives also apply to them.

Foreign residents

2.98 Proposed Division 420 applies to registered emissions units held by both Australian and foreign residents. For foreign residents the application of Division 420 is subject to the terms of any relevant double tax treaty between Australia and the country where the foreign resident resides.

2.99 Under the core income tax rules, foreign residents are subject to Australian income tax on the ordinary and statutory income that they derive from Australian sources or that is included in a taxpayer's assessable income on some basis other than having an Australian source.

2.100 Registration of an emissions unit on the Australian register is to be treated as founding an Australian source because registration on the Australian register is a clear and verifiable link to Australia. Further, the ultimate use of an Australian emissions unit is to acquit an Australian emissions liability. However, in the absence of a specific source rule, it is uncertain whether, in all cases, income arising from dealing in registered emissions units would have a source in Australia under the common law.

2.101 To ensure that amounts Division 420 includes in assessable income have an Australian source, the proceeds from selling units, increases in the rolling account balance over an income year and amounts assessable upon disposals unrelated to gaining assessable income will be treated as having an Australian source and, therefore, as assessable income of a foreign resident. ***[Schedule 2, item 19, sections 420-25(3) and 420-45(4)]***

2.102 However, for a resident of a country with which Australia has a tax treaty, the deemed source rules are subject to the treaty terms. Australia's taxing rights may be limited by the relevant tax treaty to circumstances where a foreign resident's units are connected to a permanent establishment in Australia. Where Australia has no taxing right, a foreign resident would not maintain a rolling balance account for their units or be able to claim a deduction for the cost of acquiring units. To ensure that the law achieves this result, specific rules provide that if the proceeds of selling a registered emissions unit would not have been assessable income in Australia, a taxpayer cannot deduct expenditure incurred in buying the unit or an increase in the value of any units they hold. ***[Schedule 2, item 19, subsections 420-15(5) and 420-45(5)]***

Consolidated groups of entities

Consequences when an entity joins a consolidated group

2.103 If an entity that holds registered emissions units joins a consolidated group or multiple entry consolidated group (MEC group) part way through an income year, its income year ends at the joining time (section 701-30 of the ITAA 1997). To ensure a tax neutral outcome for an entity that ceases to hold a registered emissions unit because it joins a consolidated group or MEC group, the value of the registered emissions unit at that time will be taken to be equal to:

- if the unit was held by the joining entity at the start of the income year – the value of the unit at the start of the income year

or

- otherwise – the expenditure incurred by the joining entity in becoming the holder of the unit. ***[Schedule 2, items 25-28, section 701-35]***

2.104 However, if the entity becomes an eligible tier-1 company of a MEC group, section 701-35 will not apply to set the value of registered emissions units held by the joining entity at a tax neutral amount. ***[Schedule 2, item 40, subsection 719-165]***

2.105 Under the consolidation tax cost setting rules, registered emissions units held by a joining entity will be reset cost base assets. However, the tax cost setting amount will not exceed the greater of the market value of the registered emissions units and the joining entity's terminating value for the units. ***[Schedule 2, items 31-33, section 705-40]***

2.106 The terminating value for a registered emissions unit held at the joining time will be:

- if the unit was held by the joining entity at the start of the income year – the value of the unit at the start of the income year

or

- otherwise – the expenditure incurred by the joining entity in becoming the holder of the unit. ***[Schedule 2, item 30, subsection 705-30(1A)]***

2.107 For the purpose of applying Division 420, if the head company of a consolidated group or MEC group acquires a joining entity that holds a registered emissions unit:

- the head company will be taken to have held the unit at the start of the income year in which the joining time occurs; and
- the value of the unit at the start of the income year will be the tax cost setting amount for the unit. ***[Schedule 2, item 29, subsection 701-55(3A)]***

2.108 However, where the same registered emissions unit has its tax cost set more than once in an income year, the head company will include the last tax cost setting amount as the value of the unit at the start of the income year in which the joining time occurs. ***[Schedule 2, item 20, paragraph 701-10(5)(a)]***

2.109 The head company will value the registered emissions units at the end of the income year based on the choice that it has made for valuing registered emissions units. This choice will override any choice made by the joining entity. ***[Schedule 2, item 39, item 2A of the table in subsection 715-660(1)]***

Consequences when an entity leaves a consolidated group

2.110 When an entity that holds registered emissions units leaves a consolidated group or MEC group, the units will be taken to be an asset of the head company at the end of the income year in which the leaving time occurs, but not at the start of the next income year. The value of the registered emissions unit at that time will be taken to be equal to:

- if the unit was held by the joining entity at the start of the income year – the value of the unit at the start of the income year

or

- otherwise – the expenditure incurred by the joining entity in becoming the holder of the unit. ***[Schedule 2, items 21 to 24, section 701-25]***

2.111 Under the exit history rule (section 701-40), the leaving entity will inherit the head company's choice about whether to value registered emissions units at the end of the income year using the cost method or the market value method.

Consequential amendments

2.112 Consequential amendments will ensure that the following provisions apply to registered emissions units in the same way that they apply to trading stock:

- sections 705-57, 705-163 and 705-240, which adjust the tax cost setting amount where there has been a loss of pre-CGT status of membership interests in a joining entity
- section 713-225, which adjusts the way in which the tax cost setting amounts are worked out for partnership cost setting interests. ***[Schedule 2, items 34-38, sections 705-57, 705-163, 705-240 and 713-225]***

Pay As You Go instalments

2.113 Currently, instalment income primarily includes ordinary income that is assessable. Proceeds from selling units would mainly be ordinary income. One possible exception is for units acquired for the purpose of resale at a profit. In such cases the proposed rules include gross proceeds in the taxpayer's assessable income, whereas the net gain or loss would be brought to account under the tax law's ordinary income principles.

2.114 The PAYG instalment provisions are amended so that instalment income includes all amounts included in assessable income on the sale of units. This will remove uncertainty about whether the proceeds of sales are instalment income, while furthering the aim of the PAYG instalment provisions of efficiently collecting liabilities to the Commonwealth. ***[Schedule 2, item 51, subsection 45-120(5) of the TAA 1953]***

Goods and Services tax

2.115 For the avoidance of doubt a new subsection is inserted into the meaning of supply provisions to clarify that a supply of an eligible emissions unit or a Kyoto unit is treated as a supply of a personal property right(s). ***[Schedule 2, item 1, section 9-10 of the GST Act 1999]***

2.116 The GST Act is also amended to clarify that an eligible emissions unit or a Kyoto unit is not real property for the purposes of the GST Act. ***[Schedule 2, items 5 and 6, section 195-1 of the GST Act 1999]***

2.117 Treating the supply of an eligible emissions unit or a Kyoto unit as the supply of a personal property right(s) and excluding the unit from the meaning of real property in the GST Act ensures consistent GST treatment of the various types of eligible emissions units or Kyoto units, regardless of whether they involve rights that would otherwise constitute

real property for GST purposes. The amendment to section 9-10 is made for this purpose and not because such units would not otherwise be a supply under the terms of subsections 9-10(1) or (2) of the GST Act.

2.118 The amendments also clarify that a supply of an eligible emissions unit or a Kyoto unit, being the supply of a right, can be GST-free under item 4 of the table in subsection 38-190(1) of the GST Act.

2.119 A new subsection is inserted into section 38-190 of the GST Act to ensure that the supply of an eligible emissions unit or a Kyoto unit is not a supply directly connected with real property. This means that paragraph (a) of item 2 or item 3 in the table in subsection 38-190(1) of the GST Act may apply to make that supply GST-free despite any direct connection with real property. ***[Schedule 2, item 2, section 38-190 of the GST Act 1999]***

2.120 The terms ***eligible emissions unit*** and ***Kyoto unit*** are defined in the GST Act by reference to their meaning in the *Carbon Pollution Reduction Scheme Act 2009*. ***[Schedule 2, items 3 and 4, section 195-1 of the GST Act 1999]***

Example 2.10

An Australian resident company is registered for GST and carries on a business of trading in emissions units. The company owns 10,000 certified emission reductions (Kyoto units). The Australian resident company sells the 10,000 units to a non-resident company that intends to use the units outside Australia. The supply of the units is a supply of personal property rights. Thus the supply of the units by the Australian resident company is GST-free under paragraph (a) of item 4 of the table in subsection 38-190(1) of the GST Act.

Example 2.11

A non-resident company has 5,000 emission reduction units (Kyoto units). The non-resident company does not carry on any enterprise in Australia. The non-resident company enters into an agreement with an Australian resident company to sell the 5,000 emission reduction units to the Australian resident company. The supply of the units is a supply of personal property rights. If the agreement for the transfer of the units to the Australian resident company is not made in Australia the supply of the units is not connected with Australia. Consequently GST is not payable if the units are acquired solely for a creditable purpose. If, however, the supply of the units is under an agreement made in Australia, the supply of the units is connected with Australia. Whether the supply is a taxable supply, and thus subject to GST, depends on whether the non-resident company is registered or required to be registered for GST.

Consequential amendments

2.121 Amendments that govern how the provisions in Division 420 about registered emissions units interact with the rest of the income tax law are discussed above under the heading 'Interactions of emissions units provisions with the rest of the income tax law'. Other consequential amendments are explained below.

Inclusion of definitions

2.122 The amendments to the taxation law discussed in this chapter have necessitated the inclusion of various new definitions in the taxation law and the amendment of some others. The substantive effects of these changes are discussed in the course of this chapter. The definitions included (or amended) are in the:

- ITAA 1997 ***[Schedule 2, items 40 to 50, subsection 995-1(1)]***
- GST Act 1999 ***[Schedule 2, items 3 to 6, subsection 195-1(1) of the GST Act 1999]***.

Amendment of checklists

2.123 The amendments to the taxation law discussed in this chapter have necessitated the amendment of various checklists in the ITAA 1997. ***[Schedule 2, items 8 and 9, section 10-5 and 12-5 of the ITAA 1997]***.

Application and transitional

2.124 The amendments to the tax law are to apply from the same time as section 3 of the Carbon Pollution Reduction Scheme Bill 2009 (the Main Bill). This ensures that as soon as the Carbon Pollution Reduction Scheme starts, the tax amendments can apply. The application of the tax amendments is not tied to any particular income year of the taxpayer. ***[Section 2]***

2.125 Sections 3 to 387 of the Main Bill commence on the 28th day after that Bill receives the Royal Assent. However, those sections do not commence at all if the Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2008, the Australian Climate Change Regulatory Authority Bill 2009, the Carbon Pollution Reduction Scheme (Charges—Excise) Bill 2009, the Carbon Pollution Reduction Scheme (Charges—Customs) Bill 2009 and the Carbon Pollution Reduction Scheme (Charges—General) Bill 2009 do not receive the Royal Assent on or before the 28th day after the Main Bill receives the Royal Assent. This

qualification is designed to ensure that the bills comprising the legislative package for the scheme commence together. ***[Section 2 of the Carbon Pollution Reduction Scheme Bill 2009]***

Chapter 3
Amendments to the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989*

Outline of chapter

3.1 This chapter describes amendments to the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* to ensure its consistency with the Carbon Pollution Reduction Scheme (the Scheme).

3.2 The chapter outlines amendments to the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* that will include sulphur hexafluoride (SF_6), a synthetic greenhouse gas, as a controlled substance and implement a complementary measure aimed at addressing competitive distortions that arise as a result of exempting hydrochlorofluorocarbons (HCFCs) from scheme coverage and destruction arrangements.

Context of amendments

3.3 The *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* gives effect to Australia's obligations under the Montreal Protocol on Substances that Deplete the Ozone Layer and under the United Nations Framework Convention on Climate Change (UNFCCC). The *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* places obligations on importers and manufacturers of two synthetic greenhouse gases covered under the Kyoto Protocol, namely hydrofluorocarbons (HFCs) and perfluorocarbons (PFCs), which have been introduced by industry as replacements for ozone depleting gases that have been or are being phased out under the Montreal Protocol.

3.4 A third Kyoto Protocol synthetic greenhouse gas, SF_6, has not to date been regulated under the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989*.

3.5 Under the Scheme importers and manufacturers of 25,000 tonnes of carbon dioxide equivalent or more of synthetic greenhouse gases, including those contained in equipment, will be liable entities.

Entities that import or manufacture equipment containing gases controlled under the Montreal Protocol, principally HCFCs, which are direct replacements for synthetic greenhouse gases, could gain a competitive advantage over entities with scheme liabilities for synthetic greenhouse gases.

3.6 Under the Scheme entities that arrange for the recovery and destruction of synthetic greenhouse gases will be issued with Australian emissions units for each tonne of carbon dioxide equivalence destroyed. Australian emissions units will not be issued for the destruction of ozone depleting substances. Under these circumstances there will be few incentives to maintain current activities directed at the recovery and destruction of ozone depleting substances.

3.7 Complementary measures are therefore required to address these competitive distortions. Amendments to the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* are required to bring these measures into effect and, more broadly, to ensure the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* is consistent and complementary with the Scheme.

3.8 Entities that import or manufacture less than 25,000 tonnes of carbon dioxide equivalence of synthetic greenhouse gases, including those contained in equipment, may gain a competitive advantage over importers and manufacturers above this threshold. Moreover, entities that import or manufacture bulk quantities of HCFCs could gain a competitive advantage over entities with scheme liabilities for synthetic greenhouse gases. The Government will develop measures to remove the potential for market distortions resulting from application of the threshold. The Government will develop other measures to minimise competitive distortions that might otherwise arise between HCFCs and gases covered under the Scheme.

Summary of new law

3.9 The draft consequential amendments bill gives effect to five key policies:

- The first policy involves the inclusion of SF_6 as a controlled substance under the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989*. This will place reporting obligations on importers and manufacturers of this greenhouse gas and ensure consistent treatment of above and below threshold entities.

- The second policy places a prohibition on the import of HCFC-containing equipment. This will remove the incentive for consumers to increase consumption of equipment containing ozone depleting substances upon the introduction of a carbon price signal. This policy is analogous to the prohibition on equipment containing chlorofluorocarbons (CFCs) that was introduced in the 1990s and will assist Australia in meeting its international obligations under the Montreal Protocol.

- The third policy provides for revenue collected as levies under the *Ozone Protection and Synthetic Greenhouse Gas (Import Levy) Act 1995* and the *Ozone Protection and Synthetic Greenhouse Gas (Manufacture Levy) Act 1995* to be used to finance the recovery and destruction of waste scheduled substances. This will reduce any incentives for destruction facilities to preferentially destroy synthetic greenhouse gases upon commencement of the Scheme.

- The fourth policy involves the streamlining and consolidation of import licensing obligations and categories. This will involve the consolidation of all existing synthetic greenhouse gas import licences under a single licence category and amendment of reporting and levy obligations from a calendar to a financial year basis. This will align the obligations of licence holders under the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* with liable entities under the Scheme.

- The fifth policy allows for the Minister to disclose import and manufacture information to the Australian Climate Change Regulatory Authority in order to assist with compliance under the Scheme.

Comparison of key features of new law and current law

New law	***Current law***
Licensing and reporting obligations apply to importers and manufacturers of HCFCs, HFCs, PFCs and SF_6.	Licensing and reporting obligations apply to importers and manufacturers of HCFCs, HFCs and PFCs. No obligations apply to SF_6.
Levy obligations apply to importers and manufacturers of HCFCs, HFCs, PFCs and SF_6, with an exemption for importers and	Levy obligations apply to all importers and manufacturers of HCFCs, HFCs and PFCs. No obligations apply to SF_6.

New law	*Current law*
manufacturers of synthetic greenhouse gases with a carbon dioxide equivalence of 25,000 tonnes or more.	
Schedule 4 of the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* will contain a provision that prohibits the import and domestic manufacture of equipment designed to operate using CFCs or HCFCs.	Schedule 4 of the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* contains a provision that prohibits the import and domestic manufacture of equipment containing CFCs. There are presently no limits on the import of HCFC-containing equipment.
The purposes for which money credited to the Ozone Protection and Synthetic Greenhouse Gas Account can be used will include recovery and destruction programs for ozone depleting substances and synthetic greenhouse gases.	The Ozone Protection and Synthetic Greenhouse Gas Account can be used for reimbursing the costs associated with administration of the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989*; for programs to phase out ozone depleting substances; for emissions minimisation programs; and for paying costs associated with the National Halon Bank. The destruction of ozone depleting substances and synthetic greenhouse gases is not presently provided for under the account.
Importers and manufacturers of all synthetic greenhouse gases, including synthetic greenhouse gases contained in equipment, will be required to hold a Controlled Substances (SGG) Licence. Licences will be valid for two financial years.	Importers and manufacturers of bulk synthetic greenhouse gases are required to hold a Controlled Substances (SGG) Licence, while importers of refrigeration and air conditioning equipment containing an HFC or HCFC refrigerant are required to hold a Pre-charged Equipment Licence. Licences are valid for two calendar years.
Importers and manufacturers of synthetic greenhouse gases will be required to pay levies and report the quantity and composition of their imports/manufacture on a financial year basis. Importers of HCFCs will continue to pay levies and report their imports quarterly.	Importers of synthetic greenhouse gases and ozone depleting substances are required to pay levies and report the quantity and composition of their imports quarterly.
The Minister will be able to disclose information to the Australian Climate Change Regulatory Authority.	

Scheduling of sulphur hexaflouride

3.10 Schedule 1 of the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* lists those substances to which that Act applies. Parts I to VIII apply to substances listed under the Montreal Protocol, while Parts IX and X list HFCs and PFCs, respectively, which

are substances covered under the UNFCCC and Kyoto Protocol. Entities that import or manufacture scheduled substances have obligations to report the quantity and composition of their imports and, in certain cases, to pay levies consistent with the *Ozone Protection and Synthetic Greenhouse Gas (Manufacture Levy) Act 1995* and *Ozone Protection and Synthetic Greenhouse Gas (Import Levy) Act 1995*.

3.11 SF_6 is a potent greenhouse gas listed under the Kyoto Protocol. Entities that manufacture or import more than 25,000 tonnes of carbon dioxide equivalence of HFCs, PFCs and SF_6 will be liable entities under the Scheme.

3.12 To ensure that above and below threshold entities are treated consistently, SF_6 is being included within Schedule 1 of the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989*. To this end, "Part XI – Sulphur hexaflouride" is added at the end of Schedule 1. This Part only contains SF_6. ***[Schedule 1, Part 2, item 220]***

3.13 Section 7, which defines terms used throughout the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989*, is amended to include a definition of ***sulphur hexaflouride*** as "the substance referred to in Part XI of Schedule 1, whether alone or in a mixture". Moreover, the definition of ***synthetic greenhouse gas*** is amended so that it refers to "an HFC, a PFC or sulphur hexaflouride". ***[Schedule 1, Part 2, items 198-199]***

Prohibition on the import and manufacture of HCFC-containing equipment

3.14 A prohibition on the import and domestic manufacture of HCFC-containing refrigeration and air conditioning equipment is being implemented for three reasons:

- There is the potential that consumers will respond to the introduction of a price on carbon by moving to HCFC-containing equipment. Since HCFCs have very high global warming potentials, as well as ozone depleting potentials, this would be a perverse outcome.

- An increase in the installed bank of HCFC-containing equipment would, over time, place significant pressure on Australia's Montreal Protocol import quota for HCFCs. A shortage of HCFC for servicing of the bank could occur if that bank is allowed to increase unrestrained.

- Australia supports the global phase-out of HCFCs through the Montreal Protocol. A prohibition on the import and

domestic manufacture of HCFC-containing equipment would reduce global demand for such equipment and would support our international position.

3.15 This policy is analogous to the ban on CFC-containing equipment that Australia implemented in the early 1990s and is consistent with the approach pursued internationally by other developed countries.

3.16 Schedule 4 of the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* contains certain controls on the manufacture, import and use of products containing scheduled substances. Clause 10 of Schedule 4, which outlines a prohibition on the import and manufacture of CFC-containing refrigeration and air-conditioning equipment, is amended to prohibit equipment designed to operate using CFCs or HCFCs. ***[Schedule 1, Part 2, items 221-223]***

3.17 Under section 40 of the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989*, it will remain possible for a person to apply to the Minister for an exemption to this measure. Such an exemption could be granted if the product is demonstrated to be essential for medical, veterinary, defence, industrial safety or public safety purposes and if no practical alternative exists to the use of a scheduled substance in the operation of the product.

Use of the Ozone Protection and Synthetic Greenhouse Gas Account to finance recovery and destruction of ozone depleting substances

3.18 Upon commencement of the Scheme, entities that recover and destroy synthetic greenhouse gases will be credited with Australian emissions units for each tonne of carbon dioxide equivalence destroyed. Since the destruction of ozone depleting substances will not be an eligible activity for generating Australian emissions units, there is the potential for entities that currently recover and destroy ozone depleting substances to preferentially recover and destroy synthetic greenhouse gases. This would be a perverse outcome.

3.19 The Government intends to reduce any incentive against entities recovering and destroying ozone depleting substances by directly financing this activity using revenue collected under the *Ozone Protection and Synthetic Greenhouse Gas (Import Levy) Act 1995* and the *Ozone Protection and Synthetic Greenhouse Gas (Manufacture Levy) Act 1995*. Revenue from these Acts is credited to the Ozone Protection and Synthetic Greenhouse Gas Account under section 65C of the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989*.

3.20 The purposes for which the Ozone Protection and Synthetic Greenhouse Gas Account can be used are outlined in section 65D of the

Ozone Protection and Synthetic Greenhouse Gas Management Act 1989. This section is to be amended to allow for the Account to finance "recovery and destruction programs for ODSs and SGGs". ***[Schedule 1, Part 2, item 218]***

Consolidation of the Pre-charged Equipment Licence and the Controlled Substances (SGG) Licence

3.21 Currently, importers and manufacturers of scheduled substances are required under the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* to apply for and hold an appropriate import or manufacture licence. Importers and manufacturers of bulk synthetic greenhouse gases are required to hold a Controlled Substances (SGG) Licence while importers of refrigeration and air conditioning equipment pre-charged with an HFC refrigerant are required to hold a Pre-charged Equipment Licence.

3.22 In order for the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* to be consistent with the Scheme legislation, the distinction between synthetic greenhouse gases that are imported in bulk and those imported within equipment needs to be removed. Removal of this distinction requires that a single licence (an SGG Licence) applies to all synthetic greenhouse gas importers.

3.23 This is being given effect by removing references to "pre-charged equipment" and "pre-charged equipment licences". In certain circumstances, sections are repealed to take account of references to "pre-charged equipment" or "pre-charged equipment licences" having been removed. ***[Schedule 1, Part 2, items 196-197, 204-216]***

3.24 Section 9 provides an exemption from the definition of "scheduled substance" for scheduled substances in products. This section will apply in its current form to scheduled substances that are not synthetic greenhouse gases (i.e. ozone depleting substances). Therefore, section 9 is to be divided into two sections: section 9 which relates to Montreal Protocol gases (Part 1 to Part VIII of Schedule 1); and section 9A which relates to synthetic greenhouse gases (Part IX to Part XI of Schedule 1).

3.25 For synthetic greenhouse gases, an exemption is retained for products covered under paragraph 9(1)(b) which refers to a product which "consists in part of that substance only because the substance was used in the manufacturing process". It is necessary to retain this exemption as it is not practical to monitor imports of these products (principally a range of products containing polyurethane insulating foam "blown" with synthetic greenhouse gases). ***[Schedule 1, Part 2, items 202- 203]***

3.26 The effect of these amendments is that bulk synthetic greenhouse gases, synthetic greenhouse gases in pre-charged equipment (as currently defined under the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989*) and synthetic greenhouse gases in certain additional products will be controlled under a single SGG Licence. Paragraph 13(1A)(b) of the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* currently provides for exemptions from licensing requirements where the import, manufacture or export is in circumstances prescribed by the regulations.

3.27 Liable entities under the Scheme will not be required to pay a levy under the *Ozone Protection and Synthetic Greenhouse Gas (Import Levy) Act 1995* or the *Ozone Protection and Synthetic Greenhouse Gas (Manufacturing Levy) Act 1995*. It is the Government's intention to exempt liable entities from levy obligations by regulation under paragraph 13(1A)(b) of the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* or by an equivalent mechanism.

Controlled Substances (SGG) Licence duration and reporting timeline

3.28 Presently, licences awarded under the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* have a duration of two years and commence on 1 January of each even-numbered year. The reporting timeline is likewise set on a calendar year.

3.29 The licence period for SGG Licences is to be aligned with the Scheme compliance timeline. This is being given effect by amending the duration of the licence commencing on 1 January 2010. This licence will expire after 30 months. Thereafter, each SGG Licence will commence on 1 July and expire after two years. ***[Schedule 1, Part 2, items 195, 200-201]***

3.30 The reporting timeline for SGG Licences is to be likewise aligned with the Scheme compliance timeline. This is being given effect by introducing a provision that specifies a financial year-based reporting timeline for entities that import, export or manufacture synthetic greenhouse gases. Further reporting obligations are deferred to the Regulations. Offences for breach of these provisions are consistent with existing offences relating to reporting by entities. ***[Schedule 1, Part 2, item 217]***

3.31 Alignment of the reporting timeline with the Scheme provides for exempting importers and manufacturers which are liable under the Scheme from the payment of levies.

Disclosure of information to the Australian Climate Change Regulatory Authority

3.32 Entities that import or manufacture more than 25,000 tonnes of carbon dioxide equivalent of synthetic greenhouse gas will be covered under the Scheme. These entities will be required to report under the *National Greenhouse and Energy Reporting Act 2007* to the Australian Climate Change Regulatory Authority (the Authority).

3.33 To aid the Authority in the exercise of its powers, the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* will be amended so that the Minister is able to disclose information collected under that Act to the Authority. ***[Schedule 1, Part 1, item 67]***

Application and transitional provisions

3.34 The provision that allows the Minister to disclose information to the Authority takes effect from the day on which the *Carbon Pollution Reduction Scheme Act 2009* receives the Royal Assent. This is to facilitate scheme implementation by the Authority.

3.35 All other items apply from 1 July 2010.

Chapter 4
Amendments to other legislation

Outline of chapter

4.1 This chapter provides commentary on those draft amendments to other legislation included in the draft Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009 which have not been addressed in Chapters 1-3.

Context of amendments

4.2 The context of the amendments included in this Bill is described in the General Outline segment of this commentary. The amendments described in this chapter are consequential in nature and are needed to provide a comprehensive, workable scheme.

Summary of new law

4.3 This chapter addresses amendments to be made to the following Acts and Regulations consequential on the proposed Carbon Pollution Reduction Scheme Bill:

- *Renewable Energy (Electricity) Act 2000*
- *Financial Management and Accountability Regulations 1997*
- *Trade Practices Act 1974*
- *Corporations Act 2001*
- *Australian Securities and Investments Commission Act 2001*
- *Criminal Code Act 1995*
- *Anti-Money Laundering and Counter Terrorism Financing Act 2006.*

4.4 Amendments to the *Renewable Energy (Electricity) Act 2000* and the *Financial Management and Accountability Regulations 1997* are needed as a consequence of the establishment of a new regulator, the Australian Climate Change Regulatory Authority, and the transfer of functions of the Renewable Energy Regulator to the new Authority. Amendments to the *National Greenhouse and Energy Reporting Act 2007* relating to the transfer of functions are described in Chapter 1 of this commentary.

4.5 Amendments to the *Trade Practices Act 1974* and the *Australian Securities and Investments Commission Act 2001* are needed to ensure appropriate exchange of information between regulators.

4.6 Amendments to the *Corporations Act 2001* and the *Australian Securities and Investments Commission Act 2001* are needed to implement the decision to make eligible emissions units financial products.

4.7 Amendment of the *Criminal Code Act 1995* is needed to ensure that applications under the Carbon Pollution Reduction Scheme Bill are included in the list of applications in section 136 of that Act (which relates to false or misleading statements in applications).

4.8 Amendment of the *Anti-Money Laundering and Counter Terrorism Financing Act 2006* is needed to address the risk of money-laundering through trading in emissions units.

Detailed explanation of new law

Renewable Energy (Electricity) Act 2000

4.9 The Australian Climate Change Regulatory Authority, established by the proposed *Australian Climate Change Regulatory Authority Act 2009*, will administer the *Renewable Energy (Electricity) Act 2000*. References to the Renewable Energy Regulator and his or her staff are therefore deleted and references to the new Authority and its staff substituted ***[Schedule 1, Part 1, items 68-69, 73-78, 81-83].***

4.10 A new definition of 'official of the Authority' is also proposed to be included ***[Schedule 1, Part 1, item 70].***

4.11 The Australian Climate Change Regulatory Authority Bill includes provisions relating to secrecy (Part 3). For this reason, overlapping provisions (and relevant definitions) in the *Renewable Energy (Electricity) Act 2000* are proposed to be repealed ***[Schedule 1, Part 1, items 71-72, 79-80].***

Financial Management and Accountability Regulations 1997

4.12 The *Financial Management and Accountability Act 1997* sets out the financial management, accountability and audit obligations of agencies that are financially part of the Commonwealth. In particular, the Act requires agencies to manage public resources efficiently, effectively and ethically. It also requires that proper accounts and records be maintained for the receipt and expenditure of public money.

4.13 The agencies subject to this Act are prescribed in the *Financial Management and Accountability Regulations 1997.*

4.14 The Australian Climate Change Regulatory Authority, which is to be established by the proposed *Australian Climate Change Regulatory Authority Act 2009*, will administer the *Renewable Energy (Electricity) Act 2000*, the *National Greenhouse and Energy Reporting Act 2007* and the proposed *Carbon Pollution Reduction Scheme Act 2009.*

4.15 It will be prescribed in Part 1 of Schedule 1 of the *Financial Management and Accountability Regulations 1997* ***[Schedule 1, Part 1, item 11].***

4.16 The reference in these Regulations to the Renewable Energy Regulator will be deleted ***[Schedule 1, Part 1, item 12].***

Trade Practices Act 1974

4.17 The Australian Climate Change Regulatory Authority will be included in the list of agencies to which the Australian Energy Regulator can disclose information, and the list of agencies to which the Australian Competition and Consumer Commission can disclose certain information if the Chair is satisfied that it would enable or assist the Authority to perform its functions ***[Schedule 1, Part 1, items 84-86].***

4.18 This is important in ensuring the appropriate exchange of information between Commonwealth agencies. Disclosure by the Authority to the Australian Energy Regulator and the Australian Competition and Consumer Commission will be regulated by clause 48 of the draft Australian Climate Change Regulatory Authority Bill 2009.

Australian Securities and Investments Commission Act 2001 Corporations Act 2001

Financial product

4.19 Australian emissions units and eligible international emissions units are to be financial products for the purposes of the Chapter 7 of the *Corporations Act 2001* ***[Schedule 1, Part 1, item 4-6]*** and Division 2, Part 2 of the *Australian Securities and Investments Commission Act 2001* (the ASIC Act) ***[Schedule 1, Part 1, item 1].***

4.20 They will not, however, be financial products for the purpose of paragraph 12BAB(1)(g) of the ASIC Act ***[Schedule 1, Part 1, item 2]***. In brief, this states that a person provides a financial service if they provide a service that is otherwise supplied in relation to a financial product.

4.21 These amendments will provide a strong regulatory regime to reduce the risk of market manipulation and misconduct. Appropriate adjustments to the regime to fit the characteristics of units and avoid unnecessary compliance costs will be made. Further consultation will be undertaken on the adjustments that will be necessary.

Disclosure of information

4.22 The Australian Climate Change Regulatory Authority will be added to the list of agencies to which the Australian Securities and Investments Commission (ASIC) may disclose information ***[Schedule 1, Part 1, item 3].***

4.23 This means that ASIC will, for example, be able to disclose information that it possesses about wrongdoing in connection with trading of emissions units which may also be of significance to the Authority as the operator of the Registry.

Criminal Code Act 1995

4.24 Section 136.1 of the *Criminal Code Act 1995* will be amended to include applications under the proposed *Carbon Pollution Reduction Scheme Act 2009* or regulations under that Act in the list of applications to which this section applies ***[Schedule 1, Part 1, items 7-10].***

4.25 Thus a person who makes a statement in connection with an application for, for example, a registry account or an obligation transfer number, knowing it to be false or misleading (or reckless as to whether it is), would be committing an offence.

Proposed amendment of the Anti-Money Laundering and Counter Terrorism Financing Act 2006

4.26 It is proposed that Item 33 of the table of designated services at section 6 of the *Anti-Money Laundering and Counter Terrorism Financing Act 2006* be amended to include, in the capacity of agent of a person, acquiring or disposing of emissions units where the acquisition or disposal is in the course of carrying on a business of acquiring or disposing of emissions units in the capacity of an agent.

4.27 This amendment is expected to be drafted in the interval between release of this exposure draft and finalisation of the bills for introduction into Parliament.

Chapter 5
Transitional and application provisions

Outline of chapter

5.1 The purpose of this chapter is to describe the transitional and application provisions included in Schedule 1 of the draft Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009, and other provisions which have not been addressed elsewhere.

Context of amendments

5.2 The context of the amendments included in this bill is described in the General Outline segment of this commentary.

5.3 The context of the particular consequential amendments covered by this chapter is provided below.

Summary of new law

5.4 The provisions addressed in this chapter relate to:

- the transition of functions from the Renewable Energy Regulator and the Greenhouse and Energy Data Officer to the proposed Australian Climate Change Regulatory Authority (the Authority)
- the application of amendments to the *National Greenhouse and Energy Reporting Act 2007*
- transitional arrangements for amendments to the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989*
- transitional arrangements for accounts established in the National Registry of Emissions Units (the National Registry) prior to commencement of the legislation.

Detailed explanation of new law

Transitional provisions which commence at the same time as the main Bill

5.5 The transfer of functions from the Renewable Energy Regulator and the Greenhouse and Energy Data Officer to the Australian Climate Change Regulatory Authority requires various transitional provisions. These:

- Attribute functions performed by the Renewable Energy Regulator and the Greenhouse and Energy Data Officer before the commencement of the provisions to the Australian Climate Change Regulatory Authority ***[Schedule 1, Part 1, items 87-88]***
- Make a similar provision in relation to investigations by the Ombudsman ***[Schedule 1, Part 1, item 91]***
- Substitute the Australian Climate Change Regulatory Authority in proceedings to which the Renewable Energy Regulator or the Greenhouse and Energy Data Officer was a party ***[Schedule 1, Part 1, item 89].***
- Address the transfer of records from the Renewable Energy Regulator and the Greenhouse and Energy Data Officer to the Australian Climate Change Regulatory Authority ***[Schedule 1, Part 1, item 90].***
- Ensure that references in appropriate instruments to the Greenhouse and Energy Data Officer or the Renewable Energy Regulator can be read as references to the Australian Climate Change Regulatory Authority ***[Schedule 1, Part 1, item 94]***.

5.6 Information obtained by the Renewable Energy Regulator and the Greenhouse and Energy Data Officer before commencement will be subject to the secrecy provisions in the current legislation – that is, the legislation prior to repeal of the secrecy provisions in their individual Acts ***[Schedule 1, Part 1, items 92-93].***

5.7 Accounts held in the National Registry of Emissions Units prior to commencement both by private persons and the Commonwealth will continue in existence under the legislated National Registry ***[Schedule 1, Part 1, item 95].***

5.8 The designation of the various Commonwealth accounts will be unchanged ***[Schedule 1, Part 1, item 96].***

5.9 In addition, there will be power to make regulations in relation to transitional matters arising out of the amendments made by Part 1 ***[Schedule 1, Part 1, item 97].***

Application and transitional provisions which commence on 1 July 2010

5.10 Amendments to the *National Greenhouse and Energy Reporting Act 2007* relating to reports under section 19 and thresholds for reporting will apply in relation to the financial year beginning on 1 July 2010 and subsequent years ***[Schedule 1, Part 2, item 224].***

5.11 Section 46 of the *Ozone Protection and Synthetic Greenhouse Gas Management Act 1989* (which relates to quarterly reports by importers and others) continues to apply to a report in relation to a quarter ending before 1 July 2010 ***[Schedule 1, Part 2, item 225].***

5.12 The purpose of these provisions is to provide certainty for those entities required to report under these provisions.

5.13 In addition, there will be power to make regulations in relation to transitional matters arising out of the amendments made by Part 2 ***[Schedule 1, Part 2, item 226].***

Commencement provisions

5.14 The provisions described above are included in Part 1, Division 2 and Part 2, Division 2 of Schedule 1 of the draft consequential amendments bill.

5.15 Part 1, Division 2 commences at the same time as section 3 of the Carbon Pollution Reduction Scheme Bill (the main bill). This ensures that as soon as the Carbon Pollution Reduction Scheme starts, the relevant amendments can apply. ***[Clause 2]***

5.16 Sections 3 to 387 of the main bill commence on the 28th day after that Bill receives the Royal Assent. However, those sections do not commence at all if the Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009, the Australian Climate Change Regulatory Authority Bill 2009, the Carbon Pollution Reduction Scheme (Charges – General) Bill 2009, the Carbon Pollution Reduction Scheme (Charges – Customs) 2009 and the Carbon Pollution Reduction Scheme (Charges - Excise) Bill 2009 do not receive the Royal Assent on or before the 28th day after the Main Bill receives the Royal Assent. This qualification is

designed to ensure that the three bills comprising legislative package for the scheme commence together. (Clause 2 of the Carbon Pollution Reduction Scheme Bill 2009)

5.17 Part 2, Division 2 of Schedule 1 commences on 1 July 2010 [clause 2].

5.18 The commencement and application provisions relating to the amendments to the taxation legislation included in Schedule 2 of the draft consequential amendments bill are addressed in Chapter 2 of this commentary.

Formal provisions

5.19 The short title of the proposed Act is the *Carbon Pollution Reduction Scheme (Consequential Amendments) Act 2009* [clause 1].

5.20 The substantive amendments are included in Schedules 1 and 2 [clause 3].

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Schedule 1: General amendments

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