Clear the Air on Carbon Tax

Towards Net Zero

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KEY TAKEAWAYS

- Policymakers are increasing assessing the viability of green taxes, such as carbon tax, to attain their environmental goals.
- There is no specific tax treatment for carbon credit transactions in Singapore. Accordingly, businesses should consider the specific facts and circumstances of their case in determining the tax implications of their transaction.
- Given the expected hike in carbon tax, companies must consider the impact on their profit margins and business projections.

Scientists have long cautioned the world about climate change and the need to reduce carbon emissions. However, it was not until recent years that the world would sit up and act on this important message.

"Environmental, social and governance (ESG) has gained increased prominence in multinationals' boardroom agenda in the past few years, and investors are now demanding businesses to factor in ESG considerations," shared Accredited Tax Advisor (Income Tax) Tan Shao Tong, Partner, WongPartnership in a recent webinar organised by the Singapore Chartered Tax Professionals. "Policymakers are also more conscious of the environmental impacts of their country's actions (or inaction) and are increasingly assessing the viability of using green taxes, such as carbon tax, to attain their environmental goals."

Singapore's Carbon Journey

IMPLEMENTING CARBON TAX

On 1 January 2019, Singapore implemented a carbon tax[1], by way of the Carbon Pricing Act 2018, on businesses whose emissions of greenhouse gases (GHG) over a period of time has exceeded a stipulated emissions threshold.

Singapore's carbon tax, the first carbon tax pricing scheme in Southeast Asia, aims to provide a broad-based price signal to encourage companies to reduce their emissions, and is applied uniformly to all sectors (including energy-intensive and trade-exposed sectors) without exemption.

Unlike most other taxes in Singapore, carbon tax is administered by the National Environment Agency (NEA) and not the Inland Revenue Authority of Singapore (IRAS).

Under the Carbon Pricing Act, any industrial facility that emits direct GHG emissions equal to or above 2,000 tonnes of carbon dioxide equivalent (tCO_2e) annually must register as a reportable facility and submit an Emissions Report annually.

[1] https://www.nccs.gov.sg/singapores-climate-action/carbon-tax/

A reportable facility is not subject to carbon tax until it emits equal to or above 25,000 tCO_2e annually, at which point it will be required to be registered as a taxable facility. In addition to an Emissions Report, a taxable facility also needs to submit a Monitoring Plan. In the case of a taxable facility, the Emissions Report must also be verified by an accredited external auditor (except insofar as it relates to any non-reckonable GHG emissions of the facility), and be accompanied by a report by the accredited external auditor of its verification.

Currently, Singapore's carbon tax is set at a rate of $5 per tCO_2e, which is relatively low compared to other advanced economies.

Towards Net Zero

In 2020, Singapore updated its climate pledge under the Paris Agreement for emissions to peak at 65 million tCO_2e around 2030. The city-state also put forth a Long-Term Low-Emissions Development Strategy (LEDS) that aspires to halve emissions from its peak to 33 million tCO_2e by 2050, with a view to achieving net zero emissions as soon as viable in the second half of the century.

Singapore's journey towards net zero would soon be accelerated. In his Round-Up Speech for Budget 2022, Lawrence Wong, Minister for Finance (and Deputy Prime Minister since 13 June 2022), said that Singapore would take the decisive step to "accelerate the decarbonisation of our economy and achieve net zero by or around mid-century". A revised price trajectory for Singapore's carbon tax has been announced.

"To achieve our climate ambition, we will raise our carbon tax from $5 per tonne, to $25 per tonne in 2024 and 2025, and $45 per tonne in 2026 and 2027, with a view to reaching $50 to $80 per tonne by 2030. This will provide a clear price signal for businesses and individuals to internalise the costs of carbon and take actions to moderate their emissions," said Grace Fu, Minister for Sustainability and the Environment, on 30 March 2022[2]. Compared to the existing carbon tax of $5 per tCO_2e, the expected carbon tax of $80 per tCO_2e would be more in line with other advanced economies.

Grants to Assist Companies Become More Energy Efficient

It is reassuring to note that Singapore's carbon journey will not be all sticks and no carrots. There are in fact several grants made available by various government agencies to help eligible companies improve energy efficiency. For example, the Energy Market Authority of Singapore (EMA) had launched the Energy Efficiency Grant Call to co-fund up to 50% of energy efficiency projects by power generation companies. The second Grant Call closed on 31 December 2021.

NEA runs the Energy Efficiency Fund (E2F) to support businesses with industrial facilities to improve energy efficiency. Similarly, the Singapore Economic Development Board (EDB) runs the Resource Efficiency Grant for Energy (REG(E)) that supports manufacturing facilities and data centres to be more energy efficient and improve competitiveness.

[2] https://www.mse.gov.sg/resource-room/category/2022-03-30-opening-address-by-minister-at-inaugural-impact-movement

Carbon Credits and Carbon Markets

Carbon credits (or carbon offsets) generally refer to transferrable instruments certified by government agencies or independent certification bodies to represent an emissions reduction of one metric tonne of CO_2 or an equivalent amount of other GHGs. Carbon credits are issued when emissions reduction projects, such as a forestry project, are certified by government agencies or independent certification bodies.

Through carbon markets, the public and private sectors have the opportunity to purchase carbon credits from emissions reduction projects all over the world. Carbon credits may be bought, sold, or traded until they are retired. An entity that retires a carbon credit may claim the underlying reduction towards its own emissions reduction goals.

In Singapore, companies may surrender high-quality international carbon credits to offset up to 5% of their taxable emissions from 2024. This change, as announced in Budget 2022, will help to generate local demand for high-quality carbon credits and catalyse the development of well-functioning and regulated carbon markets. Companies that are able to source for carbon credits in a cost-effective manner will also benefit from this change.

Tax Treatment for Carbon Credit Transactions

While there is no specific tax treatment for carbon credit transactions in Singapore, IRAS has provided some useful guidance to help taxpayers determine the tax implications of their carbon credit transactions.

Taxation of Income from Sale of Carbon Credits[3]

General income tax principles will apply in determining whether the income arising from the sale of carbon credits is taxable, based on the facts and circumstances of each case. Essentially, if a company is trading in carbon credits, income arising from such trade will be regarded as revenue in nature. Where the company has purchased carbon credits for its business use, but sells the credits thereafter, the income derived will be considered as part and parcel of the company's business income and hence, taxable.

Deductibility of Expenditure Incurred on Carbon Credits[4]

Similarly, general income tax principles will apply in determining whether the expenditure incurred on carbon credits are deductible for tax purposes, depending on the specific facts and circumstances of each case. A company that purchases carbon credits to comply with regulatory obligations will likely be regarded as having purchased the carbon credits for use in its business. Consequently, the expenditure incurred on carbon credits will be allowable for deduction, subject to the provisions of the Income Tax Act 1947.

[3] https://www.iras.gov.sg/taxes/corporate-income-tax/income-deductions-for-companies/taxable-non-taxable-income

[4] https://www.iras.gov.sg/taxes/corporate-income-tax/income-deductions-for-companies/business-expenses/tax-treatment-of-business-expenses-(a-f)

Given its stipulated emissions threshold, carbon tax is unlikely to affect the majority of industries in Singapore in its current form. Businesses in affected industries should, however, consider (if they have not done so already) and quantify the impact of the rapidly rising carbon tax rate on their profit margins and business projections. To avoid surprises, businesses transacting carbon credits should also factor in potential tax uncertainties arising from these transactions.

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