TA 2012/6 - Deduction generation from purported purchase of offshore 'emission units' that do not exist at the time of the arrangement

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Australian Government
Australian Taxation Office

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Taxpayer Alert

TA 2012/6

FOI status: may be released

TITLE: Deduction generation from purported purchase of offshore 'emission units' that do not exist at the time of the arrangement

Taxpayer Alerts are intended to be an 'early warning' of significant new and emerging higher risk tax planning issues or arrangements that the Australian Taxation Office (ATO) has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.

Taxpayer Alerts will provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the ATO has under risk assessment will be the subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the ATO. In these latter cases the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.

Taxpayer Alerts will give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and will highlight the features which are of concern to the ATO. These issues will generally require more detailed analysis to provide the ATO view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the ATO's position through a private ruling (noting that the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the tax officer named in the Taxpayer Alert and/or obtain their own advice.

This Taxpayer Alert is issued under the authority of the Commissioner.

Overview

This Taxpayer Alert describes an arrangement where participants that are carrying on a business, contract with an offshore entity to purportedly purchase offshore 'emission units' generated through offshore carbon reduction activities, and acquire a licence to use a logo owned by the offshore entity. The offshore entity may be incorporated in a tax haven. Participants may also acquire a put option from the offshore entity which if exercised requires the offshore entity to purportedly purchase the number of offshore 'emission units' contracted for by the participant for approximately the same amount as the balance payable by the participant.

Participants are only obliged to pay a part of the purchase price upon entering the arrangement. Participants may not be obliged to pay the balance. If a participant is obliged to pay the balance, the participant may exercise the put option. This makes the financing arrangements effectively non-recourse.

The arrangement purports to allow participants to deduct the entire purchase price of the offshore 'emission units' in the income year that they enter the arrangement.

Participants are not necessarily liable entities under the *Clean Energy Act 2011*, and may not have a legal obligation under that legislation in respect of their carbon emissions. The number of the offshore 'emission units' contracted for under the arrangement is not necessarily related to participants' carbon emissions.

It is unclear whether any carbon reduction activities that may generate the offshore 'emission units' have commenced, or will ever commence. It is also unclear whether the offshore 'emission units' contracted for can be registered in Australia, or used to offset participants' carbon emissions.

Participants may not be entitled to deduct the purchase price under the purchase agreement pursuant to section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997), or any other provision.

Participants may also derive assessable income or make a capital gain on delivery of the units, or on exercise of the put option.

The anti-avoidance provisions of Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) may apply to all or part of the arrangement.

The arrangement may also incorrectly classify the purported supply of the offshore 'emission units' for the purposes of section 9-5 of *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

Context for the arrangement

The deductibility of the purchase price of an offshore emission unit, that is not a *registered emissions unit* pursuant to section 420-10 of the ITAA 1997, is determined by section 8-1 of the ITAA 1997.

Taxation Ruling TR 94/26 sets out the ATO view on the interpretation of section 8-1 of the ITAA 1997, in particular the interpretation of the word 'incurred'. Taxation Ruling TR 2006/2 sets out the ATO view on characterisation of expenses incurred in obtaining goods and services from another party under a contract. Taxation Ruling TR 95/33 outlines the ATO view of the relevance of subjective purpose, motive or intention for determining the deductibility of expenses.

Division 420 of the ITAA 1997 deals with the amounts you can deduct and the amounts included in your assessable income because you acquire, hold at the start or the end of the income year, or dispose of emission units that meet the definition of a *registered emissions unit* in the ITAA 1997. Further information regarding the *Clean Energy Legislative Package* can be found on our website **www.ato.gov.au**.

Division 9 of the GST Act defines taxable supplies, states who is liable for the GST, and describes how to work out the GST on supplies. Goods and Services Tax Ruling GSTR 2006/9 examines the meaning of 'supply' in the GST Act.

Description

The alert applies to arrangements with the same or substantially similar features to the following:

1. An entity (**the promoter**) promotes, recommends or offers to taxpayers an arrangement in which the participant that carries on a business contracts to acquire offshore 'emission units' from an offshore entity and a licence to use a logo owned by the offshore entity.
2. It purports to allow the participant to deduct the entire purchase price of the offshore 'emission units' as a marketing expense in the income year in which the participant contracts to acquire the units. It also purports not to have any GST consequences.
3. The promoter arranges for the participant to enter into the following agreements with the offshore entity:
   (a) a purchase agreement for the offshore 'emission units' (**purchase agreement**)
   - The participant agrees to acquire from the seller a set quantity of the offshore 'emission units' that purportedly will be generated through offshore carbon reduction activities.
   - The participant must pay a percentage (for example 15%) of the purchase price of the offshore 'emission units' upon entering into the purchase agreement (**first instalment**).
   - The participant is required to pay the balance of the purchase price (**second instalment**) when, or if, the offshore entity notifies the participant when it can deliver the documents allowing for crediting of the participant's registry account with the agreed quantity of the offshore 'emission units'.
   - If the offshore entity does not notify the participant within the agreed timeframe (for example, 3 years) that it can deliver the documents, the participant is entitled to terminate the purchase agreement.
   - If the participant terminates the purchase agreement, the participant is not required to pay the second instalment of the purchase price and is not entitled to a refund of the first instalment.

   (b) an intellectual property licence agreement (**licence agreement**)
   - The licence agreement entitles the participant to use a logo owned by the offshore entity for a set period.

- The participant is required to pay a minimal amount for the licence.
- The participant may use the logo to promote its business as environmentally friendly.

4. The participant may also enter into a put option agreement with the offshore entity (**put option agreement**).
   - The put option agreement enables the participant to require the offshore entity to purportedly purchase the offshore 'emission units' from the participant for an agreed purchase price (**exercise price**).
   - The exercise price is approximately equal to the second instalment under the purchase agreement.
   - The participant is required to pay an option fee for the option (**option fee**).
   - The participant may exercise the option at any time before termination of the purchase agreement.
5. The participant pays the first instalment (and an option fee, if applicable) to the promoter upon entering into the purchase agreement. The promoter retains a portion of the first instalment (and the option fee) as a fee or commission for the services it provides, and transfers the remainder to the offshore entity.
6. The offshore entity purportedly invests the remainder of the first instalment into offshore carbon reduction activities. There is no indication that any carbon reduction activities have commenced, or will ever commence.
7. For the income year in which the purchase agreement is entered into:
   - the participant records the full purchase price as an advertising or marketing expense in the participant's accounts;
   - the second instalment is recorded as a loan payable to the offshore entity.
8. The participant claims a deduction for the full purchase price in the income year that the purchase agreement is entered into.
9. There is no indication that any carbon reduction activities have commenced or will ever commence nor that any carbon reduction activities would be carried out in accordance with the Kyoto rules or other conditions prescribed by the Australian Government that must be met for resulting units to be eligible for use under the *Clean Energy Act 2011*. Accordingly there is nothing in the arrangement which would indicate that the offshore 'emission units' contracted for, if generated, would meet the definition of:
   (a) an *eligible international emissions unit* in the *Clean Energy Act 2011* or *Australian National Registry of Emissions Units Act 2011* (and therefore the definition of *an eligible emissions unit* in section 195-1 of the GST Act)*;*
   (b) a *Kyoto unit* in the *Australian National Registry of Emissions Units Act 2011*; or
   (c) a *registered emissions unit* in section 420-10 of the ITAA 1997.
10. The quantity of the offshore 'emission units' under the purchase agreement does not relate to the participant's emissions.

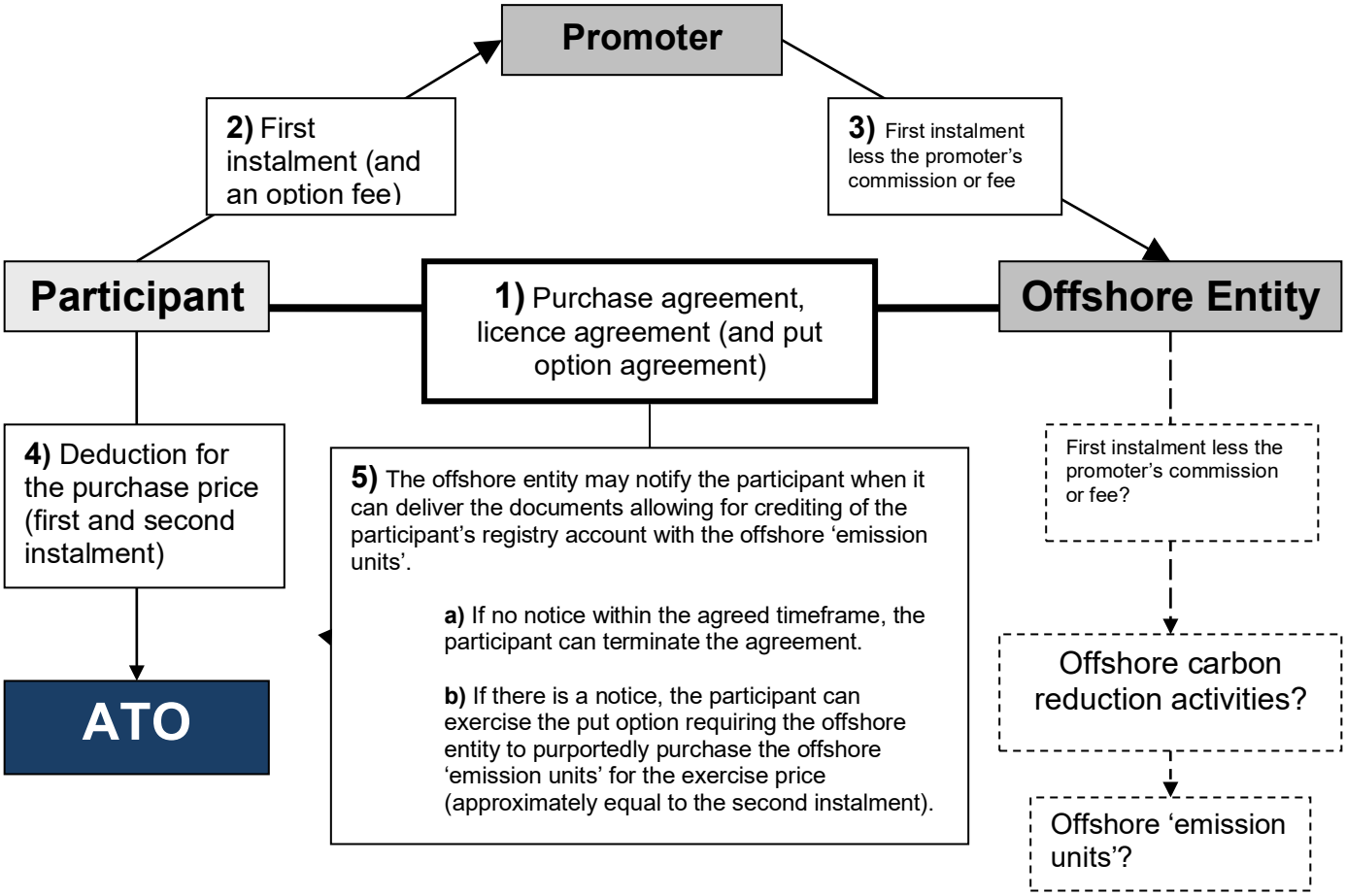
11. The offshore entity does not require any assurance that the units contracted for will be used to offset the participant's carbon emissions, nor that the number of units reflects the participant's carbon emissions, in order for the participant to be entitled to use the logo.

12. The participant does not necessarily have an account with an Australian registry.

13. The participant is not necessarily a liable entity under the *Clean Energy Act 2011,* and may not have an obligation to offset its carbon emissions.

Diagram of arrangement

The basic structure of the arrangement can be summarised diagrammatically as follows:



Features which concern us

The ATO considers that an arrangement of the type described above gives rise to taxation issues that include **whether**:

(a) the full purchase price under the purchase agreement is incurred for purposes of section 8-1 of the ITAA 1997 in the income year in which the purchase agreement is entered into;

(b) any expenses incurred by the participant under the arrangement are deductible under section 8-1 of the ITAA 1997 to any extent;

(c) any expenses incurred by the participant under the arrangement are deductible under any other provision (for example Division 420 of the ITAA 1997 or section 40-755 of the ITAA 1997);

(d) the grant, exercise and/or end of the put option results in a CGT event happening and a capital gain or loss for the grantor and/or participant;

(e) the delivery of the units, or the transfer or holding of the units in the participant's registry account, if a registry account within the meaning of the *Australian National Registry of Emissions Units Act 2011*, gives rise to:

- assessable income (for example, under Division 420 of the ITAA 1997) or
- a capital gain (for example, as a result of CGT event K1 happening pursuant to section 104-205 of the ITAA 1997);

(f) the termination of the purchase agreement for failure to deliver the documents that would allow crediting of the participant's registry account with the offshore 'emission units' within the agreed timeframe, and the subsequent cancellation of the obligation to pay the second instalment, give rise to a capital gain, or are otherwise assessable to the participant;

(g) the anti-avoidance provisions of Part IVA of the ITAA 1936 apply to the arrangement or to any part of it;

(h) the offshore entity's supply of offshore 'emission units' is a taxable supply under section 9-5 of the GST Act;

(i) the participants are entitled to input tax credits under Division 11 of the GST Act on the acquisition of the offshore 'emission units';

(j) the offshore 'emission units' satisfy the definition of an *eligible emissions unit* for the purposes of Subdivision 38-S of the GST Act;

(k) the arrangement, or steps within it, are a sham; and

(l) any entity involved in the scheme is a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Taxation Administration Act 1953*.

The ATO is currently reviewing these arrangements but on their face they exhibit features characteristic of a tax avoidance scheme.

***Note 1**: You may have already sought advice from the ATO in respect of your arrangement by way of a private ruling. If you have received a private ruling in respect of your arrangement, you can rely on that private ruling. A private ruling is legally binding on the Commissioner who will be bound to act in the way set out in the ruling, even if the private ruling is later found to be incorrect. However, a private ruling only applies to the particular entity identified and the particular scheme described in the ruling. If there is a material difference between the scheme described in the ruling, and the scheme that was actually implemented, the private ruling will not be legally binding on the Commissioner. Also, other entities cannot rely on a private ruling issued in respect of a different entity.*

***Note 2**: If you have received a private ruling in respect of your arrangement, please check that the application of Part IVA of the ITAA 1936 is considered in that ruling. The applicant may not have sought for us to rule on the application of Part IVA to the arrangement ruled upon, or to an associated or wider arrangement of which that arrangement is part. If you want us to rule on whether Part IVA applies to your arrangement, we will first need to obtain and consider all the relevant facts about the arrangement, including (if relevant) the manner in which it has actually been implemented.*

***Note 3**: Base penalties of up to 50% of the tax avoided can apply where Part IVA is applied. Base penalties of up to 75% of the tax avoided can apply where you make a false or misleading statement to the Commissioner. Reductions in base penalty will be available if the taxpayer makes a voluntary disclosure to the ATO. If you have any information about the*

*current arrangement, phone us on 1800 060 062. Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this Alert should call 13 72 86 (Fast Key Code **3 4**).*

***Note 4**: Penalties of up to 5,000 penalty units for individuals, 25,000 penalty units for bodies corporate or up to twice the amount of consideration received or receivable may apply to promoters of tax exploitation schemes under Division 290 of Schedule 1 to the Taxation Administration Act 1953. The Commissioner can also apply to the Federal Court of Australia for restraining and performance injunctions against promoters where prohibited conduct has occurred, is occurring or is proposed.*

***Note 5**: A registered tax agent may have their registration cancelled or suspended by the Tax Practitioners Board under the Tax Agent Services Act 2009 for breach of a condition of registration including being penalised for being a promoter of a tax exploitation scheme.*

***Note 6**: The Commissioner may amend an assessment at any time where he is of the opinion there has been fraud or evasion. See Law Administration Practice Statement PSLA 2008/6.*

Amendment history

Date	Comment
3 May 2024	Updated Tax Agent tip off hotline number
19 January 2024	Updated ATO tip-off hotline numbers

References

Subject references:

- CGT events
- deductions and expenses
- goods and services tax
- incurred
- input tax credits
- offshore
- taxable supply

Legislative references:

Income Tax Assessment Act 1997

- Section 8-1
- Section 40-755
- Section 104-205
- Division 420

Income Tax Assessment Act 1936

- Part IVA

Taxation Administration Act 1953

- Division 290 of Schedule 1

A New Tax System (Goods and Services Tax) Act 1999

- Section 9-5
- Section 195-1
- Division 9
- Division 11
- Subdivision 38-S

Clean Energy Act 2011

Australian National Registry of Emissions Units Act 2011

Related Practice Statements:

- PS LA 2008/6
- PS LA 2008/15

Related Rulings/ Determinations:

- TR 94/26

- TR 95/33
- TR 2006/2
- GSTR 2006/9

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