Understanding the tax costs of carbon trading in Singapore

KPMG in Singapore

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Introduction

As Singapore's carbon credit market gears up, further clarity on what taxes traders will face on these transactions will help bolster this nascent market.

Companies are increasingly looking to buy carbon credits to offset their greenhouse gas emissions and potentially reduce their carbon tax liabilities. Large emitters in Singapore are exploring this with new vigour given that the country's carbon tax will be raised in coming years. In turn, the local carbon credit market is gearing up to meet demand, with new trading platforms being established.

Those trading carbon credits must ensure that they understand the tax consequences of their transactions in terms of both goods and services tax (GST) and direct tax. Under existing laws, carbon trading in Singapore may generate GST for various parties involved, given that current exclusion categories for GST do not clearly apply to the voluntary trade of credits. The question of exempting such transactions could be clarified by the Singapore government in order to foster the country's carbon trading market.

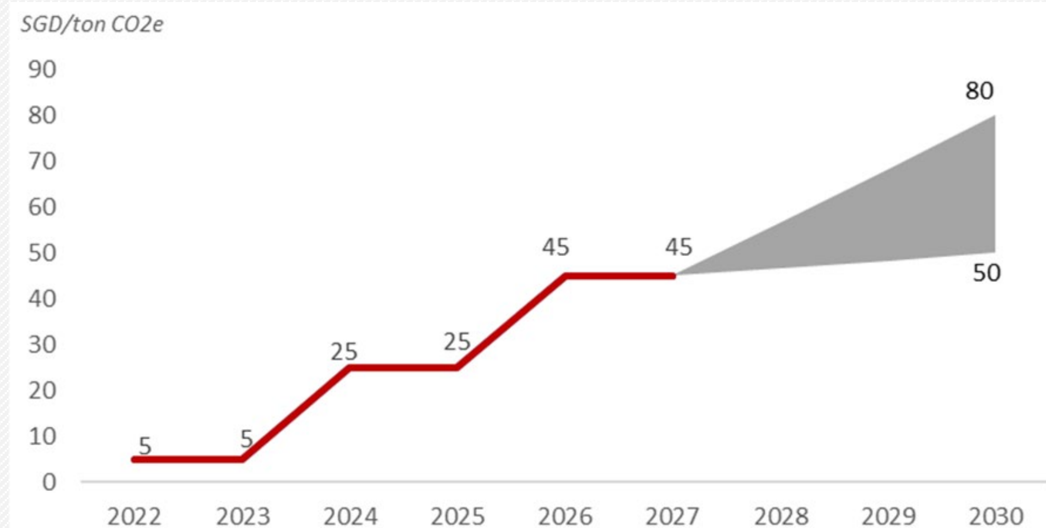
The application of direct tax to carbon trading in Singapore is clearer cut; income from selling carbon credits is regarded as taxable revenue, and costs incurred from purchasing them would generally be regarded as tax-deductible business expenses.

Large emitters taxed in their purchase of carbon credits could pass on such costs to their customers and the general public, in the form of higher energy prices for example. Carbon exchanges may also face a dilemma over whether to bear the tax costs associated with their trading or pass them on to buyers. The government may wish to consider exempting carbon trading from GST, as other countries have done.

Outlook for Singapore's Carbon Tax

Demand for carbon credits will increase among emissions-intensive enterprises, such as petrochemical companies, when Singapore hikes its carbon tax from 2024. This tax applies to industrial facilities producing more than 25,000 tCO2e per year. Such heavy emitters will be allowed to offset up to five percent of their taxable emissions by purchasing high-quality international carbon credits.

While Singapore set its initial carbon tax rate purposefully low at S$5 per tonne of CO2 equivalent (tCO2e) generated when it was introduced in 2019, the tax is now set to increase over three phases. It will rise to S$25 in 2024 and to S$45 in 2026, before increasing to between S$50 and S$80 per tC02e by 2030. The idea is to signal the government's gradual shift towards greener energy solutions, while giving businesses time to adapt without any immediate adverse impacts on competitiveness.



What are carbon credits and how does carbon trading work?

A carbon credit is a form of tradeable permit that warrants the holder the right to generate one tonne of carbon dioxide emissions. There are two broad types available – regulatory compliance-linked credits and offset credits – though these terms are sometimes used interchangeably.

Compliance-linked credits function as a permission slip to emit the "purchased" amount of carbon. In Singapore, these are issued by the National Environmental Agency (NEA) and are used to settle a company's carbon tax liability. They are currently priced at S$5 per credit.

Carbon offset credits may be considered as the trading between companies of their carbon footprints. An offset credit is generated for every unit of carbon removed from the atmosphere through activities including direct carbon capture, reforestation or solar energy projects. Heavy emitters can purchase such credits to reduce their own carbon footprints, even though there has been no equivalent reduction in their actual emissions.

Setting aside credits used for regulatory and compliance purposes, the voluntary carbon credit market has four key participants – project developers, accreditation and standards bodies, platform brokers/operators, and end-buyers. Developers, platform operators and end-buyers may all be liable for GST when trading voluntary carbon credits in Singapore under current rules.

Types of carbon credit

Compliance-linked credits

- Mandatory in order to obtain permission to emit carbon
- Usually purchased from the authorities or government

Carbon offset credits

- Purchased voluntarily by companies to offset their carbon footprints
- Traded between companies

Key participants involved in the voluntary carbon markets

Project developers

Project developers design and implement carbon offset projects – for the reduction of carbon emissions or removal of carbon. Carbon credits are generated from these projects to be sold.

Standards bodies

Standards bodies including the Verified Carbon Standard (Verra) and The Gold Standard assess and verify the carbon offset credits generated to be sold.

Platform brokers

Certified carbon offset credits can be purchased in the carbon credit market through platforms or brokers.

End-buyers

End-buyers can purchase carbon offset credits to reduce their emissions or on-sell to others. Such credits are retired from the registry once utilised.

Q&A: GST implications of carbon trading in Singapore

The current GST treatment of voluntary carbon credits traded in Singapore may affect market uptake on account of tax cost. Businesses should be aware of these costs before participating in the market. The government could clarify the GST treatment of carbon trading and, if desired, provide clear exemption categories in order to foster Singapore's carbon credit market.

Does GST apply to carbon credit transactions?

The sale of carbon credits by businesses is classified as a "supply of rights" to emit the amount of carbon covered by the credit. Given that Singapore GST principles class "supply of rights" as a "supply of services", GST is applicable to such transactions.

Are there any clear exemptions from GST for such transactions?

The legislation specifically provides that the issuance of carbon credits by the NEA does not constitute a supply for GST purposes, meaning that compliance credits are not taxable in Singapore.

How about voluntary credits sold by businesses?

The NEA exemption does not apply to voluntary transacting of carbon credits issued by businesses. These transactions do not clearly fall under any out-of-scope category in current Singapore legislation. Therefore, GST will be charged on such transactions when sold by a GST-registered person to a buyer in Singapore.

Who will bear the GST costs in such transactions?

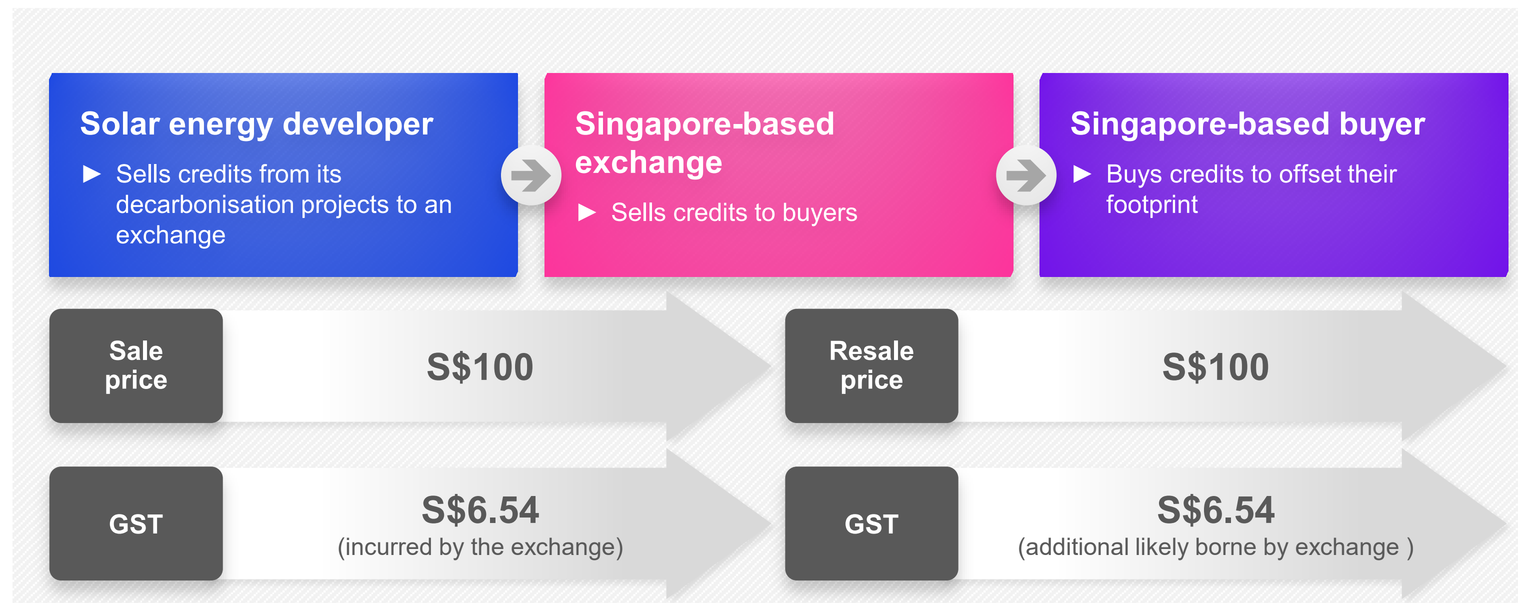
Carbon credit issuers should charge GST at the standard rate to any buyer in Singapore, but a zero rate to buyers outside the country. The same GST treatment applies when a buyer of a carbon credit sells it on to another person or an exchange. The carbon credit purchasers will have to bear these GST costs unless they are able to pass them on to their buyers.

What would this look like in practice?

Take the example of a seller transferring a carbon credit to an exchange (as a central counterparty) at S$100, and the exchange then transferring this to a Singapore buyer at S$100. If this is a standard-rated supply, either 7% GST on S$100 or S$100 as GST-inclusive (7/107 X 100 = $6.54) would be charged. Given that buyers are unlikely to be willing to pay the GST, the Exchange would have to charge the S$100 as GST-inclusive and bear the S$6.54 as output tax, creating a loss for the exchange.

Could this create a compounding effect of tax-on-tax?

If all parties within the trading circle are GST-registered and can claim back their GST in full, there will be no concern. However, this is not the case if one of the parties is not GST-registered, or is registered but unable to claim back the GST that it incurs in full. Therefore, such a treatment presents a tax cascading effect.



Are there any circumstances in which the above transactions could be GST-exempt?

While various types of financial services are treated as exempt under the GST Act, none of the exempt provisions clearly covers transactions involving carbon credits. Trading of such credits comes closest to the GST exemption category of *"provision or assignment of any contract for the sale of any unallocated commodity which does not lead to a delivery of the commodity from the seller to the buyer".*[1] Carbon credits would qualify for this category if considered to be unallocated commodities and if they are not physically delivered to a buyer.

Are carbon credits considered to be unallocated commodities?

Goods are considered to be unallocated if they are an unidentifiable part of a larger stock of goods held by the supplier. While carbon credits are allocated unique serial numbers and may come from different projects – such as from various forestry projects across Indonesia and Malaysia, for example – each category of credit is traded on a fungible basis. The credits are identical in that each represents one tCO2e reduced, avoided or removed from the atmosphere. In this regard, carbon credits are arguably akin to unallocated commodities in terms of classification for tax purposes, though they are not strictly commodities.

1. List of Financial Services – An Excerpt of the GST Act - https://www.iras.gov.sg/media/docs/default-source/uploadedfiles/pdf/list-of-financial-services.pdf?sfvrsn=4dcb1161_2

Will the delivery of credits affect whether they are GST-exempt?

If a buyer does not take physical delivery of the carbon credits purchased, there are grounds to argue that their sale constitutes or presents similar characteristics to the exemption for the supply of unallocated commodities described above. However, if the buyer requests physical delivery of the credits – for the purpose of retiring them from the market, for example – this would not readily fit any of the exempt supply categories outlined in the current GST legislation. Hence, a specific provision would have to be incorporated if exemption should apply to such circumstances.

What if credits that are physically delivered were considered exempt?

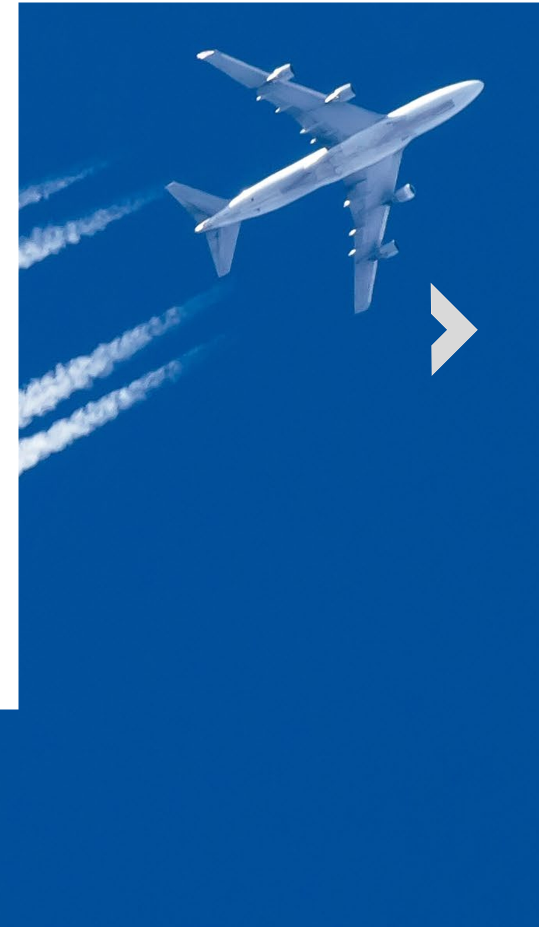
There could be calls not to treat physically delivered carbon credits as an exempt supply. However, if not considered an exempt supply they would no longer be aligned with the GST treatment of the "unallocated commodities trading" exemption provision.

Are there any other circumstances in which carbon credit trading could be exempt and yet the GST incurred could be claimed back?

If a supply is treated as integral to the business of taking taxable supplies, such as in the event that an airline is legally required to purchase carbon credits, the current GST legislation has adequately taken care of this implication and would allow the business's full input tax claim. Hence, there would be no GST cost for such a business.

Could there be any changes to the current system?

Singapore tax authorities may yet choose to review its GST legislation in response to the development of the local carbon market – other countries have already opted to make voluntary carbon credit transactions exempt from or outside the scope of GST. This would reduce cost barriers for traders, further boost local market activity and help the country to become a carbon service and trading hub for the Asia Pacific.



Other countries' tax treatment of carbon trading

KPMG has reviewed the GST positions of the UK and New Zealand, given that Singapore has modelled most of its GST provisions on those of these countries and in view of the progression of carbon credit trading in Europe. The GST / Value-Added Tax (VAT) positions taken by these jurisdictions could inform how carbon credit trading is characterised for taxation purposes elsewhere, and help to understand what Singapore could consider in order to be at the forefront of this emerging market.

Both the UK and New Zealand have amended their legislation to cater for carbon credit transactions. The UK has treated certain carbon credits as outside the scope of VAT and New Zealand has zero-rated them.

The UK's VAT position

The UK applies different VAT treatments to compliance market and non-compliance market credits. The country applies a standard rate to the supply of compliance market carbon credits, which include those recognised under the statutory Kyoto Protocol and EU Emissions Trading System 'cap and trade' regimes. UK allowances and EU allowances may also benefit from the zero rate of VAT when sold on a UK commodity exchange, although conditions apply.

Purchases of non-compliance market credits – known as Verified Emission Reduction credits – are currently outside the scope of UK VAT. This is because the HMRC consider that no particular service is rendered to the purchaser that can be identified as a cost component of its business, although it may receive a general reputational benefit (in the form of good public relations, marketing and corporate responsibility)[1]. Please note that as the secondary trading market for Verified Emission Reduction credits expands, the current outside-the-scope VAT treatment may be revisited.

New Zealand's GST position

Emissions unit transactions are generally zero-rated in New Zealand[2]. These include New Zealand government issued units, Kyoto-compliant units and approved overseas units. Emissions units that do not fall within these descriptions – sometimes called "grey market" or "voluntary" units – have also been zero-rated under the NZ GST Act since 2010[3].

A summary of GST/VAT treatment of carbon credits under these different countries' current laws is shown below.

Country	Compliance credits	Voluntary credits
► **Singapore**	Standard rate	Standard rate
► **UK**	Standard rate	Out of scope
► **New Zealand**	Zero rate	Zero rate

1. HMRC VAT manual VATSC06584 - https://www.gov.uk/hmrc-internal-manuals/vat-supply-and-consideration/vatsc06584
2. https://taxpolicy.ird.govt.nz/en/publications/2009/2009-sr-gst-emissions-trading/gst-changes-relating-emissions-trading-scheme
3. Section 11A(1)(w) of the NZ GSTA, 'the supply is a sale or other disposal of services that are a unit—
   i. issued by reference to the sequestration, or avoidance of emission, of human-induced greenhouse gases; and
   ii. other than an emissions unit; and
   iii. verified to an internationally recognised standard'

Direct tax implications of carbon trading

The application of direct tax to carbon trading in Singapore is clearer cut than GST. The basic concepts of corporate taxation in Singapore apply to the trading of carbon credits – taxability of gains and deductibility of expenses generally depend upon whether the transactions are “capital” or “revenue” in nature and, in the case of expenses, whether they are incurred wholly and exclusively in the production of income.

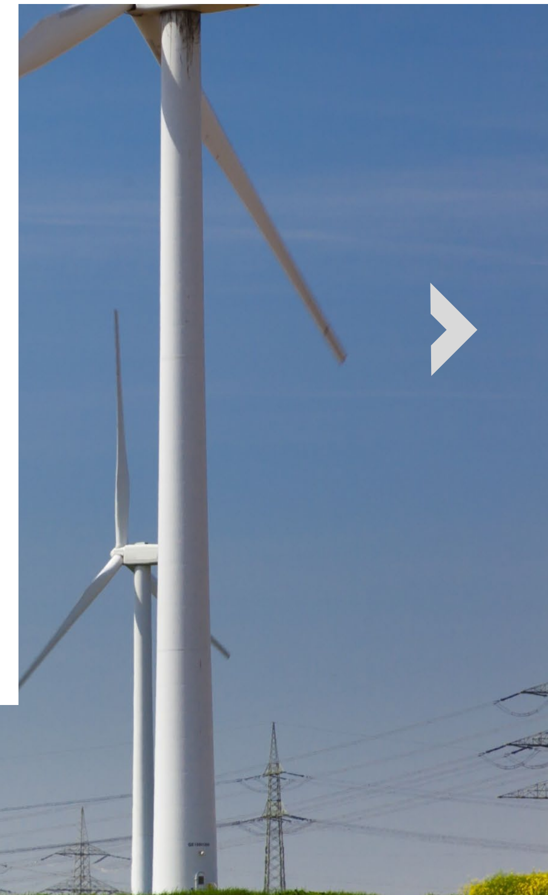
For a company trading carbon credits, related income and gains would simply be regarded as revenue, and would be taxable. Accordingly, associated expenses incurred would generally be regarded as tax-deductible business expenses (including costs incurred through the purchase of carbon credits).

The Inland Revenue Authority of Singapore has also recently clarified two points:

- In the event that carbon credits are purchased for use in the business but are subsequently sold, any income derived should still be considered to be taxable as part of the company’s business.
- Where a company incurs expenses purchasing carbon credits to comply with regulatory obligations, these should be regarded as business expenses and are deductible.

These clarifications are helpful for taxpayers and signal that the Government is looking to provide as much certainty as possible regarding corporate income tax implications, with a view to enhancing Singapore’s position as a carbon trading hub.

Carbon credits are also included as qualifying products under Singapore’s Global Trader Programme incentive, which provides for reduced tax rates on trading income. This is good news for commodity traders who are considering Singapore as a potential location for their carbon trading desks.



How can KPMG help?

With the increasing urgency to reduce emissions and reach national net-zero targets by 2050, Singapore's carbon trading market will continue to grow.

The tax teams at KPMG in Singapore are well-positioned to partner with you in your journey towards environmental sustainability by helping you to

- increase your awareness of the tax landscape for carbon trading,
- identify opportunities for tax optimisation
- ensure that you comply with the relevant laws and regulations.

In addition, we also represent businesses to seek tax certainty and concession on the treatment where current legislation is unclear.

Please reach out to any of the key contacts listed to discuss further.

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