

Some Tax Aspects of the Carbon Market

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There are a number of proposals now before Brazil's National Congress to create a Carbon Emissions Trading System in Brazil ("SBCE" – *Sistema Brasileiro de Comércio de Emissões*), based on the National Climate Change Policy.

Related areas

Tax

One of these proposals, Bill PL 528/2020 (along with additions and substitutions proposed by member of Congress) deals with some of the tax aspects of transactions on the SBCE, especially transactions involving Verified Emissions Reduction Credits and Greenhouse Gas Emission Permits.^[1]

Topics

Carbon Tax

As originally drafted, Bill PL 528 had only one provision that made a general reference to the tax aspects of transactions on the SBCE: Article 8 provided that legal entities would be exempt from paying the gross revenues contributions, PIS (Social Integration Program) and Cofins (Social Security Financing), and from the contribution on profits, CSLL (Contribution on Net Profit), but made no mention of corporate income tax (IRPJ – Imposto de Renda da Pessoa Jurídica).

The new version of Bill PL 528, which is currently under review by the Chamber of Deputies' Environmental Commission, makes certain improvements where tax matters are concerned.

According to the new version, revenue earned by any legal entity from sale of Verified Emission Reduction – VER credits or GHG Emission Permits – Per-GHGs is exempt from PIS, Cofins, and CSLL. It also provides for an exemption from IRPJ for 30 years.

Even though revenue and profit from SCBE transactions are exempt from taxation, the amended version also provides that administrative and financial expenses incurred to issue, register and trade VER credits are deductible in calculating taxable income under the actual profit method – which is a positive change.

Nonetheless, questions can arise as to the tax treatment given to the sale of carbon market instruments (VERs and Per-GHGs) by their original holders, especially with respect to PIS and Cofins. The fact is that the legal nature of these new credits/instruments is not clear, raising questions as to whether they should be considered "intangible assets", in which case revenue from their sale is not subject to PIS and Cofins, by express legal provision.

Defining the legal nature of VERs and Per-GHGs for tax purposes would be an advance over the previous legislation dealing with carbon credits (known as CBios), which is silent on this point.

Neither the original text of Bill PL 538 nor any of its amendments contains provisions on the tax aspects of subsequent sales of VER credits (secondary market). Ideally, the tax exemptions should be expressly extended to secondary sales, as a question of tax policy.

At the very least, the law should establish the applicable tax treatment, in function of the trading environment (e.g. the stock market) or the nature of the asset. For assets traded on the stock market, as a rule the income tax on capital gains is 15% rate of the net gain. Where assets are sold by individuals, the capital gain is subject to progressive rates from 15% to 22.5%.

For example, it would be possible to establish a rule that treats sales of VER credits on the secondary market as stock market transactions, regardless of where the sale is made, so that gains from VER credits are subject to tax of 15%.

Similarly, the law should expressly provide that amounts spent to acquire Per-GHGs are deductible for income tax purposes (IRPJ/CSLL). Those amounts should also generate PIS and Cofins credits for companies that are under the non-cumulative regime.

In short, defining the tax effects of transactions on the SBCE through express and objective legislative provisions is essential to avoiding legal uncertainty and, indirectly, discouraging development of the sector. If the legislator's intention is to create tax neutrality for transactions on the SBCE, then the required tax mechanism should be established by law.

NOTES:

^[1] Creation of the SBCE would be combined with a mechanism for offset of GHG emissions, via Verified Emission Reductions (VERs). Thus, if regulated entities have an excess of GHG in their inventories, they would have two options: (i) acquire Per-GHGs, or (ii) offset the excess emissions with VERs.

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