GST on Carbon Credits

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Carbon and its impact on Environment and Natural Resources is a very big issue and concern globally. The whole world is looking towards reduction in carbon emission and have taken pledge for the same.

Carbon Credits

The acknowledgment of the importance of decreasing carbon emissions originated with the signing of the Kyoto Protocol under the United Nations Framework on Climate Change (UNFCCC) in 1997. In this accord, participating nations, including India, pledged to constrain and diminish emissions of greenhouse gases (GHGs).

Carbon credits are generated through a process that involves quantifying, verifying, and certifying the reduction or removal of greenhouse gas emissions. Such credits issued or received as per government guidelines can be sold to the entity who is not able to reduce the carbon emission as required under Law / Protocol.

This article deals with this "New age concept" of carbon credits w.r.t Goods and Services Tax (GST).

Taxability of Carbon Credits under Indirect Taxes

GST is a consumption-based tax. Going by the legislative scheme of the GST laws, GST is applicable either on goods or services or both. Thus, anything which is neither "goods" nor "services" can never be subject to levy of GST. Being so it needs to be examined whether Carbon Credits are goods or services for levying GST.

Section 2(52) of the Central Goods and Services Tax Act, 2017 ("CGST Act") defines the term "goods" as "every kind of movable property other than money and securities but includes actionable claims, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply." Further, the term "services" has been defined under section 2(102) of the CGST Act as "anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination to another form, currency or denomination for which a separate consideration is charged."

It becomes evident that both money and securities have been explicitly excluded from the categories of goods and services. Consequently, if carbon credits meet the criteria of being classified as "money"

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or "securities," their supply would fall beyond the purview of taxable transactions under GST.

Whether Carbon Credits can be money

An analysis of the definition of "money" under Section 2(75) of the CGST Act suggests that Carbon Credits do not meet the criteria for being classified as money, nor do they fit into the specific instrument categories mentioned in the definition. Furthermore, it is important to highlight that the Reserve Bank of India has not acknowledged the use of such certificates as a valid method for fulfilling obligations.

Whether Carbon Credits are Securities

"Securities" under GST are the same as defined in clause (h) of section 2 of the Securities Contract (Regulation) Act, 1956 ("SCRA") i.e. "Securities include-

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate.;

(ia) derivative;

(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

(ic) security receipt as defined in clause (zg) of section 2 of ten Securities and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(id) units or any other such instrument issued to the investors under any mutual fund scheme;

(ii) Government Securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights and interest in securities"

Carbon Credits may be treated as "Securities" as they appear to fall under the wide term, "other marketable securities of a like nature in or of any incorporated company or other body corporate".

Whether CERs can be goods:

To be classifiable as "goods", it must be movable, marketable and must not be money or securities. These criteria have been extensively discussed by the Hon'ble Supreme Court in various cases. In Vikas Sales Corporation, Hon'ble Supreme Court dealt with the issue of taxability of "replenishment licenses or R.E.P. licences" issued under the Export Import (EXIM) policy to provide to the registered exporters the facility of importing the essential inputs required for the manufacture of the products exported. It was held that the license is not only a beneficial interest in respect of a movable property not in possession of the person but is itself a valuable right which is freely transferable. The import license, therefore, must be treated as merchandise and clearly falls within the definition of "goods". In Yash Overseas, the Apex Court held that Duty Entitlement Pass Book (DEPB) is identical to REP licenses and qualify as goods on the basis that it is freely marketable and have an intrinsic value.

From the above discussion, it can be said that Carbon Credits may qualify as "goods" as they have intrinsic value and are movable and freely transferable and tradable. Moreover, Carbon Credits always have had a market of their own.

The issue pertaining to determine the nature of Carbon Credit/CERs as goods, was deliberated under the Notification No. 256/CDVAT/2009/43 dated 13.01.2010 issued by the Commissioner, Trade and Taxes, Delhi VAT under section 85 of the Delhi VAT 2004. The Commissioner analyzed the definition of "goods", "dealer" and "sale" under the Delhi Value Added Tax (DVAT) Act, 2004. Thereafter, vide the said Notification, CERs were declared as goods under the DVAT law.

Further, Carbon Credits were declared as goods under the Securities Contracts (Regulation) Act, 1956. The National Commodity & Derivative Exchange Limited (NCDEX) vide the Circular No. NCDEX/TRADING-035/2008/080 dated April 7, 2008, notified the launch of future/forwards contract pertaining to Carbon Credit. Further, pursuant to the repeal of the Forward Contracts (Regulation) Act, 1952 (FCRA) and amendment to the Securities Contracts (Regulation) Act, 1956 (SCRA), the Central Government vide Notification No. S.O.3068(E) dated September 27, 2016 notified carbon credits as goods for the purposes of clause (bc) of section 2 of SCRA. i.e. to be treated as commodity derivative which is not a security.

Carbon Credits, also, appears to be alike Priority Sector Lending Certificates (PSLCs) and Renewable Energy Certificates (RECs). PSLCs are tradable certificates issued against priority sector loans of banks so as to enable banks to achieve their specified target and sub-targets for priority sector lending through purchase of these instruments in the event of a shortfall and at the same time incentivizing the surplus banks to lend more to these sectors. Therefore, it is evident that CERs, RECs and PSLCs are the certificates having intrinsic value traded in the market.

A new section 194Q was introduced vide Finance Act, 2021 to Income Tax Act, 1961. It applies to any buyer who is responsible for paying any sum to any resident seller for purchase of any goods of the value or aggregate of value exceeding fifty lakh rupees in any previous year. It has been clarified vide Circular No. 13 of 2021 dt. 30.06.2021 that transactions in electricity, renewable energy certificates and energy saving certificates traded through power exchanges registered in accordance with Regulation 21 of the Central Electricity Regulatory Commission (CERC) are not covered under section 194Q.

This amendment also suggests that the RECs need to be considered as goods. If this view is accepted, then CERs may also need to be treated as goods only.

Further, the Central Government issued the Circular No. 34/8/2018-GST dated 01.03.2018 and Circular No. 46/20/2018-GST dated 06.06.2018, whereby the applicability of GST on PSLCs and RECs has been clarified. The government vide the latter clarified that RECs, PSLCs etc. are classified under heading 4907 and will accordingly attract GST @ 12 % instead of

18% under the residual head, which was earlier clarified by the Circular No. 34/8/2018-GST dated 01.03.2018. Further, Ministry of Finance, Department of Revenue vide its Notification No. 8/2021-Central Tax (Rate) dated 30.09.2021 has clarified that applicable GST rate for Heading 4907 is now 18% w.e.f. 1st October 2021.

In case GST is paid on purchase of Carbon Credits, input tax credit should be available subject to the provisions of section 16 and 17 of the GST Act.

Credit of GST paid on Carbon Credit purchase

The question will arise as to whether such purchase of Carbon Credits will amount to use in manufacture and hence credit will be available?

The plain reading of the provision suggests that the credit of units purchased are ultimately linked to manufacturing process only and hence, credit should be available. However, on the contrary, being in the nature of penalty, credit may be denied. In such cases clarity from Government will be essential and useful to avoid litigation in future.

Conclusion

Given the objective of carbon trading, which aims to reduce greenhouse gas emissions and promote the utilization of renewable energy within industries, imposing a tax on the supply of Certified Emission Reductions (CERs) appears ill-suited.

Notably, duty credit scrips such as Merchandise Exports from India Scheme (MEIS) and The Service Exports from India Scheme (SEIS), issued under the Foreign Trade Policy (FTP), have been exempted through Notification No. 34/2017-CT(R) dated 13.10.2017. In a similar vein, carbon credits deserve comparable treatment due to their contribution to addressing global warming. It is advisable for the legislative body to take proactive measures to clarify taxability under GST law, and a timely resolution would be highly beneficial.

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