

**IN THE COURT OF COMMISSIONER
DEPARTMENT OF TRADE AND TAXES**

No. 256/CDVAT/2009/43

Dated: 13.01.2010

NOTIFICATION

Ruling u/s 85 of DVAT Act, 2004

Sub. : Levy of Tax on Certified Emission Reductions (CERs) commonly known as carbon credits

No. 256/CDVAT/2009/43 – Shri B.L. Sharma, Joint Commissioner (L&J), Department of Trade and Taxes has filed an application u/s 85 of the DVAT Act, 2004, seeking clarification/ruling u/s 85 of the DVAT Act, 2004 on the following two points:-

- a. Whether CERs (carbon credits) are taxable under the DVAT Act, 2004?
- b. If yes, then what is the rate of tax on the sale of CERs (carbon credits)?

The said application has been filed for the purpose of notifying the exact legal position in respect of taxability of the item CER, both to the authorities subordinate to Commissioner (VAT), Government of NCT of Delhi and the entities/dealers who are carrying on or who may undertake such transactions.

2. While explaining the nature of transactions of carbon trading and its historical aspects, the applicant in the application dated 28.10.2009 has stated that carbon trading is an activity which has come into existence in the wake of global warming and concerted efforts being made by international community to contain and progressively reduce emission of Greenhouse Gases by industrial units, vehicles and other fossil fuel consuming machines, etc.

Carbon trading is a transaction of sale of carbon credits by an entity/unit which has earned/obtained Certified Emission Reductions (CERs) to an entity which is committed to reduction for emission greenhouse gases, but is not able to achieve the prescribed reduction in emission of greenhouse gases on its own. The CERs are certified by appropriate authority (Executive Board of CDM). The CERs, in essence, is a certificate having market value and is a tradable item/commodity.

Carbon credits basically seek to encourage countries to reduce their greenhouse gas (GHG) emissions, as it rewards those countries that meet their targets and provides financial incentives to others to do so as quickly as possible. Reduction in emission of GHG emission is achieved by development of renewable energy projects, fuel substitution, energy efficiency improvement, waste heat utilization, management of methane emission from municipal landfills & agriculture and cattle manure, etc.

Surplus credits that are acquired by overshooting the emission reduction targets can be sold in the global market. One credit is equivalent to one tonne of CO₂ emission reduced. Carbon credits are available for companies engaged in developing renewable energy projects that offset the use of fossil fuels.

3. The Multi-Commodity Exchange of India (MCX), the country's leading commodity exchange, may soon become the third exchange in the world with a licence to trade in carbon credits.

4. Carbon Credit trading has acquired a lot of significance consequent upon the implementation of Kyoto Protocol which was signed in December, 1997. The Third Conference of Parties (COP) to the United Nations Framework Convention on

Climate Change (UNFCCC) had adopted the Kyoto Protocol. The Protocol requires developed countries to limit their Greenhouse Gas (GHG) emissions to individual targets, resulting in, on an average 5.2% reduction in the GHG emission from their 1990 emission levels in the commitment period 2008-12. The protocol for the first time, in the evolving climate change regime, provided for legally binding emission commitments by parties. The protocol covers six main Greenhouse gases CO₂, CH₄, N₂O Hydrofluorocarbons, Perfluorocarbons and Sulphur Hexafluoride. The protocol provided three Co-Operative Implementation Mechanisms (CIMs) to enhance flexibility and to facilitate development of cost effective means of achieving the targets. These mechanisms are Joint Implementation and Emission Trading, both of which are co-operative mechanisms applicable to Developed Countries only. Clean Development Mechanism (CDM) provides for co-operation between the developed countries and developing countries.

5. Clean Development Mechanisms (CDMs)

CDMs are of particular interest to developing countries, as the same provide for investment in projects in developing countries for their sustainable development, while generating GHG abatements that may be transferred to the developed countries towards meeting their targets under Kyoto Protocol. CDMs provide for alternative technological options and incentives to developing countries, to pursue their socio-economic goals but with lesser climate change impacts.

The operational mechanism of CDMs involves an investment by a legal entity from a developed country in a project in developing country, which results in emission reductions. The investment decision would include an agreement between the two parties and their respective countries on the dispensation and transfer of the emission reductions resulting from the project. These emission reductions have to be certified by an appropriate authority (the CDM Executive Board, provided for under the protocol) and then these certified Emission reductions (CERs) commonly known as carbon credits can be used to meet commitments under Kyoto Protocol.

6. The manner of transfer of CERs will depend on the nature of agreement between the contracting parties. Some of the preferred modes adopted by interested parties include:

(a) Investment by an entity from a developed country directly in a project, in a developing country in lieu of the CERs that are expected to accrue therefrom.

(b) The entity in a developed country enters into agreement to purchase CERs from a developing country entity or access the open market, as and when they are required to meet certain commitments.

(c) Governments of some of the developed countries are floating tenders for procurement of CERs.

(d) There are multilateral institutions like the World Bank and IFC, which have been engaged by governments and private sector corporations to purchase carbon credits (CERs) on their behalf. The World Bank group has nearly US\$ 1.06 billion of such funds for buying CERs. Similarly, there are other funds set up by EBRD, JBIC and some governments.

(e) Some of the MNCs and large corporates are themselves buying carbon credits.

(f) CDM provides for banking of CERs, wherein the emission reductions prior to 2008 may be banked for use in the commitment period i.e. 2008-12.

The scheme/arrangement of transfer/sale of carbon credits by entities in developing countries to entities in developed countries for meeting their

commitments has given an opportunity to the developing countries like India to trade in carbon credits.

7. India is considered as the largest beneficiary claiming about 31% of the total world carbon credit trade and as per one estimate, it is expected to rate in, at least, US \$ 5 billion to US \$ 10 billion (Rs. 22,500 crore to Rs. 45,000 crore) over a period of time.

Polluters in India exempted from emission cuts, otherwise imposed on industries in Europe, America and the developed countries under the Kyoto Protocol, have already started slashing their Greenhouse Gases and would sell the resulting surplus carbon credits to entities in developed countries over the next few years. Carbon credits have opened a new horizon for Indian companies and there is a huge market open for India till 2012 which is the target date for reducing the carbon emission in accordance with provisions of Kyoto Protocol. There is going to be a scramble to buy credits which will lead to enormous trade in carbon points in India. The carbon trading is going to have large scale revenue implications for State Governments including Delhi in the ensuing years.

8. The questions raised in the above-said application in respect of which ruling has been sought is as to whether carbon credits are taxable under the DVAT Act or not and as to what is the rate of tax on such transactions. In this connection, it is relevant to refer to the definition of term “goods” as it figures in clause (m) of sub-section (1) of Section (2) of DVAT Act which reads as under:-

“goods” means every kind of moveable property (other than newspapers, actionable claims, stocks, shares and securities) and includes –

- (i) livestock, all material, commodities, grass or things attached to or forming part of the earth which are agreed to be served before sale or under a contract of sale; and
- (ii) property in goods (whether as goods or in some other form) involved in the execution of a works contract, lease or hire-purchase or those to be used in the fitting out, improvement or repair of movable property”.

9. It is also relevant to refer to the term “dealer” as contained in clause (j) of sub-section (1) of Section (2) which lays down that:-

“dealer” means any person who, for the purposes of or consequential to his engagement in are in connection with or incidental to or in the course of his business, buys or sells goods in Delhi directly or otherwise, whether for cash or for deferred payment or for commission, remuneration or other valuable consideration and includes –

- (i) a factor, commission agent, broker, del credere agent or any other mercantile agent by whatever name called, for the purposes of or consequential to his engagement in or in connection with or incidental to or in the course of the business, buys or sells or supplies or distributes any goods on behalf of any principal or principals whether disclosed or not;
- (ii)
- (iii)
- (iv)
- (v)
- (vi)
- (vii)

10. Equally relevant is to refer to the definition of term “sale” as contained in clause (zc) of sub-section (1) of Section 2 of DVAT Act, 2004, which reads as follows :

“sale” with its grammatical variations and cognate expression means any transfer of property in goods by one person to another for cash or for deferred payment or for other valuable consideration (not including a grant or subvention payment made by one government agency or department, whether of the Central Government or of any State Government, to another) and includes –

- (i)
- (ii)
- (viii)

11. A careful examination of the product called Certified Emission Reductions (CERs) commonly known as carbon credits shows that it is a certificate having market value. There are people/entities who are willing to sell and others who are willing to purchase such certificates. The intrinsic nature and value of carbon credits coupled with their free transferability makes the said product a marketable commodity. The said product is therefore covered under the definition of the term “goods” as it figures in sub-section (1) of Section 2 of DVAT Act, 2004.

Further, any person/company/entity undertaking the activity of sale and purchase of carbon credits (CERs) is a dealer in terms of the definition of the dealer as contained in sub-section (1) of Section 2 of DVAT Act, 2004. The transaction of sale of carbon credits (CERs) by a person/entity to another person/entity constitutes “sale” in terms of the definition of term as contained in Section 2(1)(zc) of DVAT Act, 2004.

12. It is also pertinent to refer to Entry No. 3 of IIIrd Schedule appended to the DVAT Act, 2004 which reads as follows :-

Entry No. 3 of IIIrd Schedule

“01-04-2005

All intangible goods like copyright, patent, rep license, goodwill etc.”

The nature, substance and manner/modalities of the trading of CERs (carbon credits) makes the product known as Certified Emission Reductions (CERs) similar to the products mentioned in the said entry. Thus, the item CER is covered by the aforesaid entry.

13. Reliance is also placed on the judgement of Hon’ble Supreme Court in the case of Yash Overseas vs. Commissioner of Sales Tax and Others (Civil Appeal No. 2155 of 2000) wherein it was, *inter alia*, held that :

“REP licences had always a market. There were people willing to sell and others willing to buy REP licences at all times. Their innate value coupled with free transferability made REP licences into a marketable commodity. They were “goods” properly so called, having innate value and a ready market.

Under the Duty Entitlement Passbook (DEPB) Scheme, an exporter is eligible to claim credit as a specified percentage of the job value of exports made in freely convertible currency. The credit is available against such export products and at such rates as may be specified by the Director General of Foreign Trade by a public notice issued in this behalf. The DEPB is exactly the same as REP licence. Like the REP licence, it has an innate value which makes it a marketable commodity. The DEPB credit is also clearly “goods” within the meaning of the sales tax laws”.

14. It is also worthwhile to refer to the judgement of the Hon'ble Supreme Court in the case of M/s Vikas Sales Corporation (2) (1996) 4 SCC 433 wherein the Apex Court had observed that:

“When these licences/scripts are being bought and sold freely in the market as goods and when they have a value of their own unrelated to the goods which can be imported thereunder, it is idle to contend that they are in the nature of actionable claims. It was assumed that actionable claims are not transferable for value and that was the difference between “actionable claims” and those other goods which are covered by the definition of “goods” in the Sales of Goods Act, 1930, and the sale tax laws. The assumption was fallacious and the conclusion in so far as it was based on this erroneous perception, equally wrong”.

It is also relevant to the judgement of the Hon'ble Supreme Court in the case of Tata Consultancy Services vs. State of Andhra Pradesh wherein, it was, *inter alia*, held that :-

“A “goods” may be tangible property or an intangible on. It would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capable of being bought and sold and (c) capable of being transmitted, transferred, delivered, stored and possessed. If a software whether customized or non-customized satisfies these attributes, the same would be goods”.

The product known as Certified Emission Reductions (CERs) has got utility/market value, is capable of being bought and sold and capable of being transmitted, transferred, delivered, stored and possessed. Thus, all the three attributes as laid down by the Hon'ble Supreme Court in the above said case are getting fulfilled in the present case as well.

CERs (carbon credits) by virtue of its intrinsic nature, its financial/monetary value has acquired a status of a commodity. The Multi-Commodity Exchange of India (MCX), the country's leading commodity exchange is also trading in the CERs or carbon credits along with other commodities like precious, semi-precious metals, petroleum, kirana items etc.

15. Careful examination of the nature of product known as carbon credit (CERs), the nature of the transactions of sale and purchase as explained in the application filed by Shri B.L. Sharma, Joint Commissioner (L&J), keeping in view the provisions of DVAT Act, 2004 referred to above and the law laid down by the Hon'ble Supreme Court in the aforesaid judgements, the ruling on the questions raised by the applicant in his application filed u/s 85 of the DVAT Act, 2004 is given as follows :-

(a) The items/product known as Certified Emission Reductions (carbon credits) is taxable under the DVAT Act, 2004.

(b) The rate of tax in respect of the abovesaid item/product is 4% as the said item is covered by Entry No. 3 of IIIrd Schedule appended to DVAT Act, 2004.

16. This ruling shall come into force from the date of its publication in the Official Gazette.

Jalaj Shrivastava
Commissioner (T&T)