Emissions Trading Scheme to commence 1 July 2014

July 2013

On 16 July 2013 Prime Minister Kevin Rudd announced that the Government will bring forward the start of the flexible-price emissions trading scheme under the carbon pricing mechanism from 1 July 2015 to 1 July 2014.

From 1 July 2014 the carbon price will be set by the market as Australia moves to a "cap and trade" emissions trading scheme (ETS). Under the ETS, the Government will cap the amount of carbon pollution that may be emitted each year and the market determines the carbon price in the context of this cap.

Under the previous arrangements, the carbon price was to be $25.40 per tonne in July 2014. Under a floating price, the figure is now expected to be around $6 per tonne. This change will reduce input costs for business and boost competitiveness. The move also brings Australia into step with major trading partners such as China, Germany, France and the UK.

The revised start date is expected to cost the budget around $3.8 billion over the forward estimates. The Government will make up for lost revenue through $3.9 billion of savings, including $1.8 billion of savings from changes to fringe benefits tax arrangements relating to employer-provided cars. Details of the new savings are listed under Budget Impact below.

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The Carbon Price

On 10 July 2011 the Government launched the Clean Energy Future package, the Government's policy framework for tackling climate change. The centrepiece of the package was the Government's carbon pricing mechanism, which came into effect on 1 July 2012. From 1 July 2012 – 1 July 2014, the carbon price is fixed, before moving to a floating price Emissions Trading Scheme (ETS) from 1 July 2014 onwards. In addition to the carbon price, the package contained compensation measures for households and business; investments in energy efficiency and renewable energy; and investments in agriculture and land use.

The carbon price was set at $23 per tonne of emission for the 2012-13 financial year. This price will rise by 2.5 per cent per year in real terms over until 1 July 2014, when the carbon pricing mechanism moves to a floating price ETS.

The Government will then put annual caps on the amount of carbon pollution that can be released into the atmosphere by entities covered by the carbon price. A price ceiling will apply for the first three years of the flexible price period.

The Climate Change Authority (CCA) was also established to provide expert advice on key aspects of the carbon pricing mechanism. Former Reserve Bank Governor and former Treasury Secretary, Bernie Fraser is CCA's Chairman. The CCA will recommend to Government future pollution caps under the ETS. The Government will then make final decisions on these pollution caps, based on the CCA's recommendations. The CCA's Renewable Energy Target Review Final report is available here. The Government's response to the report is available here.

Link to the EU Carbon Market

In August 2012 the Government announced that when the Australian carbon price moves to a floating price ETS, it would be linked with the European Union ETS.

Launched in 2005, the EU ETS is the largest carbon market in the world, operating in 30 countries including the 27 EU Member States plus Iceland, Liechtenstein and Norway. The EU is Australia's second largest trading block, and linking the Australian ETS to the EU scheme has been a long-term goal of the Government. The announcement was the result of several months of negotiations between the Australian Government and the European Commission.

Linking the two schemes will enable participants in one scheme to use units from another scheme for compliance purposes. This will provide benefits including reducing the cost of cutting carbon pollution, increasing market liquidity and supporting global cooperation on climate change.

At first, the schemes will be linked one-way, whereby Australian businesses will be able to use EU carbon units to help meet liabilities under the Australian ETS. A full two-way link with mutual recognition of carbon units will be established no later than 1 July 2018. Australian companies will be able to purchase EU carbon units for future compliance in Australia with immediate effect.

To facilitate linking, the Australian Government made two changes to the design of the Australian carbon price. These were that:

- a price floor of $15 per tonne will not be implemented; and
- a new sub-limit will apply to the use of eligible Kyoto units. While liable entities in Australia will still be able to meet up to 50 per cent of their liabilities through purchasing eligible international units, only 12.5 per cent of their liabilities will be able to be met by Kyoto units.

In making the announcement, former Minister Combet described the linking as the best outcome for Australia, both economically and environmentally. He said that this would be the first of many future ETS linkages, and announced that he was already in negotiations with his New Zealand counterpart to discuss also linking the NZ ETS.

Former Minister Combet's press release from 28 August 2012 is available here. The European Commission has produced a list of Frequently Asked Questions on the linking of the two schemes, available here.

On 16 July 2013 the Government announced its intention to bring forward the operation of the ETS to 1 July 2014, including the link to the EU's ETS. The Government will be seek the agreement of the EU to give effect to this commitment.

Compensation and Adjustment Measures

Revenue raised from the carbon price was allocated by the Government to fund adjustment and compensation measures, as well as to support energy efficiency and renewable energy initiatives.

The Government planned for over half the money raised from the carbon price to be used to assist households. The Government estimated that nine in ten households would receive a combination of tax cuts and payments to help with the costs of the carbon price. The compensation was targeted at Australians in the greatest need, particularly pensioners and low and middle income households. On average, households were predicted to see cost increases of $9.90 per week, while the average assistance was set at $10.10 per week.

The announcement by the government to bring forward the ETS to 1 July 2014 is predicted to further lower household costs in 2014-15 by $380 on average over the year. This includes an estimated $150 reduction per year on average household expenditure on electricity bills, and an average reduction of $57 over the year on gas bills.

Tax Cuts

From 1 July 2012, all taxpayers with incomes of up to $80,000 received a tax cut, with around 60 per cent of taxpayers getting a tax cut of at least $300. These tax cuts are designed to help Australians manage the impacts on prices from the carbon price, and to participate in the transition to a clean energy future.

Payments

Further assistance will be provided to people who receive government payments such as the Age Pension, Disability Support Pension, Carer Payment, Newstart Allowance and Family Tax Benefit, through increases in these payments. The introduction of the carbon price is expected to result in a one off increase in prices of 0.7 per cent in 2012-13. In order to ensure low-income households are able to cover their average expected price impact, most government payments will be increased by an amount equivalent to 1.7 per cent of the maximum rate.

This assistance will first be delivered to eligible recipients through a one-off, tax-exempt, lump sum Clean Energy Advance from May 2012. After that, assistance will be paid through a new Clean Energy Supplement at the same time as payments.

An additional tax-exempt Low Income Supplement will be available for low-income households who might not receive enough assistance through tax cuts or Government payments to offset their average expected cost impact under a carbon price. The supplement can be applied for and will be paid through Centrelink, on an annual basis as a lump sum of $300 from 1 July 2012.

On 16 July 2013 the Government announced that the move to the ETS on 1 July 2014 would not impact on the Household Assistance Package. Recipients of government payments will continue to receive ongoing assistance through payments of the Clean Energy Supplement, indexed to growth in the Consumer Price Index.

Renewable Energy

The carbon price and ETS provide a significant market based incentive for the development of clean technologies, especially renewable energy. To complement this market signal, the Clean Energy Future package also facilitates targeted investments to bring forward new technologies at as low a cost as possible through two key organisations: the Clean Energy Finance Corporation and the Australian Renewable Energy Agency.

A Clean Energy Finance Corporation

A new commercially oriented Clean Energy Finance Corporation (CEFC) has been established to drive innovation through commercial investments in clean energy through loans, loan guarantees and equity investments. The CEFC will have $10 billion to implement its mandate.

The CEFC will leverage private sector financing for renewable energy and clean technology projects, investments critical to the transformation of the Australian economy. It will identify projects and remove barriers that would otherwise prevent the financing of large scale renewable energy projects. Investments will focus on renewable energy, energy efficiency and low emissions technologies and the transformation of existing manufacturing businesses to re-focus on meeting demand for inputs for these sectors.

The CEFC will be run by an independent board made up of experts in banking, investment management and clean energy and low emissions technologies. It will commence operations on 1 July 2013.

More information on the CEFC is available in Hawker Britton's occasional paper, here.

The Australian Renewable Energy Agency

A new, independent statutory body, the Australian Renewable Energy Agency (ARENA), will be created to consolidate administration of $3.2 billion in Government support for renewable energy technology innovation previously administered by the Australian Centre for Renewable Energy (ACRE), the Australian Solar Institute (ASI) and the Department of Resources, Energy and Tourism.

ARENA will be established as an independent statutory body, and will adopt a holistic approach to financing the research, development, commercialisation and demonstration of renewable energy technologies.

ARENA will commence operations on 1 July 2012.

The 2013-14 Budget extended funding for ARENA by two years to 2021-2022

Energy Efficiency

The Clean Energy Future package also includes initiatives to reduce carbon pollution by improving energy efficiency for households, businesses, local governments and community organisations.

Living Greener Website

The Government has launched the LivingGreener website, which encourages household energy efficiency, and consolidates information on programs and financial support available from the Australian Government as well as state and territory governments to improve energy efficiency.

Low Carbon Community

The Low Carbon Communities program initially provided $330 million to fund projects to help low income households, local governments and community organisations save energy. In the 2013-14 Budget $98 million of uncommitted funds was return to the Budget.

Remote Indigenous Energy Program

The Remote Indigenous Energy Program will provide around 55 remote indigenous communities with funding to install renewable energy systems, reducing reliance on diesel for electricity generation.

Land Use

The Government has announced it will exclude the agricultural and land sectors from the carbon price. These sectors will be able to benefit from the Carbon Farming Initiative.

The Carbon Farming Initiative will provide new economic rewards for farmers and landholders that take steps to reduce carbon pollution. It will do this by creating credits for each tonne of carbon pollution which can be stored or reduced on the land. These credits can then be sold to other businesses wanting to offset their own carbon pollution.

The Carbon Farming Initiative will create a new income stream for farmers, new jobs for rural and regional Australia and provide strong incentives to identify and implement low-cost methods of pollution reduction. An Indigenous Carbon Farming Fund will provide $22.3 million over five years to support Aboriginal and Torres Strait Islander people to participate in the Carbon Farming Initiative (CFI).

The Clean Energy Future package also establishes a new Biodiversity Fund to help support restoration and protection of biodiverse carbon stores. The ongoing Fund will provide $946 million over six years from 2011-12.

The Government has inscribed a legally binding 2020 target under the Kyoto mechanism, which includes improved international carbon accounting rules. The Government can now elect to adopt additional land-based activities in its 2020 target, meaning that Carbon Farming Initiative credits from forest management, cropland management, grazing land management and revegetation are eligible for use by liable entities in the carbon pricing mechanism.

As a result, the CFI Non Kyoto Fund is no longer necessary and will not proceed, saving $234.7 million over four years to 2016-17.

Budget Impact

Bringing forward the start date of emissions trading to 1 July 2014 is expected to cost $3.8 billion over the forward estimates. The government has announced a range of savings measures worth $3.9 billion in order to ensure there is no net impact on the budget bottom line. They include:

- reforms to the car fringe benefits tax saving $1.8 billion over the forward estimates;
- ending the Energy Security Fund two years early in light of the changes to the scheme since it was first legislated (with a doubling of the allocation in the 2014/15 year) with a positive impact of $770 million over the forward estimates;
- an adjustment to the Coal Sector Jobs package allocation in 2014/15 consistent with the lower carbon prices worth $186 million;
- a deferral of $200 million of funding from the Carbon Capture and Storage program and the return of $24 million to budget consistent with the profile of potential projects;
- the return of unallocated funding from the Biodiversity Fund to the budget equivalent to $213 million over the forward estimates;
- the return of $143 million of unallocated funding from the Carbon Farming Futures program to the budget;
- a re-phasing of $200 million of funding from the Clean Technology Program and return of $162 million of unallocated funding to the budget; and
- reforms to the APS management structure (Executive and Senior Executive Service level) and more efficient procurement of agency software worth around $248 million.

Reforms to the fringe benefits tax exemption for cars

As part of the savings measures announced to fund the move to a floating price on carbon from 1 July 2014, the government announced an overhaul of the fringe benefits tax exemption for cars. The reform removes the statutory formula method previously used for both salary-sacrificed and employer-provided cars and is expected to save the Government $1.8 billion over the forward estimates.

Under the current system, a fringe benefit arises where an employee is provided with a car for private use. A ‘car fringe benefit’ is valued using either the operating cost ‘log book’ method or the statutory formula method. The operating cost method calculates the fringe benefit as the cost of running the car multiplied by the proportion of personal use of the car worked out by a log book. The statutory formula method is the cost of the car multiplied by 20%, regardless of actual personal use of the car. This provides a significant tax concession for taxpayers using their car fringe benefit for private travel, because it assumes a significant proportion of the for business purposes.

The reform announced removes the statutory formula method for new contracts entered into after announcement and existing contracts materially varied after 16 July 2013. All car fringe benefits for new leases will be calculated using the operating cost method.

The reform will not affect 3.6 million workers – such as employees, the self-employed and sole traders – claiming deductions for work-related travel expenses when they use their own car for work reasons. The changes also do not impact on the existing exempt car benefit concessions for taxis, panel vans, utes and other non-car road vehicles.

Legislation

On 13 September 2011, the Government introduced the enabling legislation to enact its Clean Energy Future policies. The legislative package was subsequently referred to a Joint Select Committee. The Committee's membership reflected the makeup of the Parliament, with representatives from the major parties and the cross bench. The committee's report was released on 7 October 2011 and is available here.

On 21 September 2011, Minister Combet released updated modelling showing the impact of the carbon tax at the price of $23 per tonne. The modelling showed that the economy will continue to undergo strong growth, while domestic emissions will fall to nearly half of what they would be without carbon pricing by 2050. The updated modelling is available here.

On 12 October 2011, the package was passed by the House of Representatives, with support from Greens MP Adam Bandt and Independents MPs Rob Oakeshott, Andrew Wilkie and Tony Windsor. The legislation was passed by the Senate on 8 November 2011.

The Government's Clean Energy Future legislative package is made up of 18 separate bills:

1. Clean Energy Bill 2011
2. Clean Energy (Charges—Customs) Bill 2011
3. Clean Energy (Charges—Excise) Bill 2011
4. Clean Energy (Consequential Amendments) Bill 2011
5. Clean Energy (Customs Tariff Amendment) Bill 2011
6. Clean Energy (Excise Tariff Legislation Amendment) Bill 2011
7. Clean Energy (Fuel Tax Legislation Amendment) Bill 2011
8. Clean Energy (Household Assistance Amendments) Bill 2011
9. Clean Energy (Income Tax Rates Amendment) Bill 2011
10. Clean Energy (International Unit Surrender Charge) Bill 2011
11. Clean Energy Regulator Bill 2011
12. Clean Energy (Tax Laws Amendments) Bill 2011
13. Clean Energy (Unit Issue Charge—Auctions) Bill 2011
14. Clean Energy (Unit Issue Charge—Fixed Charge) Bill 2011
15. Clean Energy (Unit Shortfall charge—General) Bill 2011

16. Climate Change Authority Bill 2011
17. Ozone Protection and Synthetic Greenhouse Gas (Import Levy) Amendment Bill 2011
18. Ozone Protection and Synthetic Greenhouse Gas (Manufacture Levy) Amendment Bill 2011

In 2012 the Government passed legislative amendments which enabled the link between the Australian and European Emissions Trading Schemes. The amendments alter the Clean Energy Act 2011 and the associated Acts listed above. There are three amending bills in total:

1. Clean Energy Amendment (International Emissions Trading and Other Measures)
2. Clean Energy (Charges-Excise) Amendment
3. Clean Energy (Charges-Customs) Amendment

The Government's decision to bring forward the operation of the ETS to 1 July 2014 will require legislation. It is understood that the Government's intention is to legislate that change after the 2013 Federal election.