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Carbon Tax in India: A Way Forward

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ABSTRACT

Sustainable development is the catch word of the modern world concerning geo pollution and industrial development. It means that development and environment must go hand in hand. Our environment scenario is also based on the concept of sustainable development and the Judicial Forums in India have followed this approach. The Supreme Court of India time and again has stated that the right to a clean environment is a basic aspect of life which is protected by Article 21 of the Constitution of India. Several principles like the Polluter Pays Principle, Public Trust Doctrine, Precautionary Principle, Absolute Liability, etc. are applied in the sub-continent so that two things can be achieved- restoring the environment as it was before the pollution and also compensate the people who suffered as a result of the unchecked pollution. Every such acts of compensatory nature are to be undertaken by the industries causing pollution when directed by the Judicial Forums. But here is a catch. In the Indian Sub-continent, cases take years to be decided and the pollution goes on unabated. A carbon tax is imposed by the Government to put a direct cost on the green house gas emissions by the industries which acts as an economic incentive for the industries to lower their carbon output into the environment. The Finance Act, 2017 introduced section 115 BBG under the Income Tax Act, 1961 “in order to bring clarity on the issue of taxation of income from transfer of carbon credits and to encourage measures to protect the environment.” The Income Tax Act, 1961 also encourages measures to protect the environment is a good step forward but also at the same time hints at the rising level of pollution in the Indian sub-continent.

Keywords: *sustainable development, common but differentiated responsibility, revenue receipt, capital receipt, carbon credit.*

I. INTRODUCTION

The concept of carbon credits was developed to address the increasing levels of greenhouse gases (GHGs) such as carbon dioxide, methane, and nitrous oxide in the atmosphere. These rising GHG levels lead to higher global temperatures, sea level rise, and severe environmental consequences like floods, droughts, and heat waves.

To tackle these issues, the United Nations Framework Convention on Climate Change

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(UNFCCC) was created. This international treaty emerged from the United Nations Conference on Environment and Development (UNCED), commonly known as the "Earth Summit," held in Rio de Janeiro in June 1992. The UNFCCC sets non-binding GHG emission limits for countries, aiming to stabilize GHG concentrations in the atmosphere and prevent harmful human-induced effects on the climate system.

In 1997, delegates from over 160 nations convened in Kyoto, Japan, to establish regulations for carbon emissions. The participating countries were segmented into Annex 1 and Non-Annex 1 categories. Annex 1 countries (developed nations) committed to reducing their greenhouse gas (GHG) emissions by 5.2% during the initial commitment period from 2008 to 2012. Non-Annex 1 countries were not mandated to reduce emissions.

To regulate emissions, the carbon credit system and Cap and Trade program were introduced. A carbon credit represents the reduction of one ton of CO₂ (carbon dioxide) or its equivalent in other greenhouse gases. Each country is allocated a maximum emission limit, referred to as the CAP. If a country surpasses this limit, it must procure carbon credits from countries that have emitted less than their allocated cap, thereby establishing a market-driven mechanism for emission management.

II. UNDERSTANDING CARBON TAX AND ITS EXAMPLES

The concept of carbon taxes was first introduced in the 1990s. The Scandinavian countries were the pioneers in imposing carbon taxes, with Finland taking the lead, followed by Norway, Sweden, and Denmark.

A carbon tax is a fee imposed on the carbon dioxide emissions generated during the production of goods and services. It serves as a deterrent to the usage of these fuels, ultimately reducing the carbon footprint in the atmosphere. The tax amount is directly proportional to the carbon output or emission into the atmosphere.

This taxation system acts as a monetary disincentive for companies and industries to transition from traditional fossil fuels to greener energy sources, promoting greater efficiency and a cleaner environment while combating global warming and climate change.

Initially, the carbon tax was set at Rs 50 per ton of coal produced and imported. However, it has since increased to Rs 400 per ton, indicating India's proactive steps toward controlling carbon emissions and achieving carbon neutrality by 2070 in line with its international obligations.

The carbon tax is paid by both consumers and producers. Producers pay a set amount of tax for

each ton of greenhouse gas emitted into the atmosphere, which is currently set at Rs 400 per ton. Ultimately, this cost is passed on to consumers, resulting in higher prices for products. This price increase can lead to reduced demand, prompting companies to shift to cleaner energy sources, benefitting the environment and reducing consumer costs.

According to a study prepared by UNFCCC, there is momentum building around the world for carbon pricing instruments, with 40 national and 25 sub-national jurisdictions implementing carbon pricing initiatives, covering 8 gigatons of CO₂e, equivalent to 15% of global greenhouse gas emissions.

The Paris Agreement of 2015 was a pivotal moment for international climate action. For the first time, all nations came together to combat climate change. The Agreement aims to keep global temperature rise well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the increase even further to 1.5 degrees Celsius. It sets provisions for enhanced cooperation among nations on climate change mitigation, including market-based approaches such as carbon pricing. India is committed to abiding by the Paris Agreement in line with its international obligations

III. NEED FOR CARBON TAX IN INDIA

“Sustainable development” is a key concept in today's world, particularly in balancing environmental concerns with industrial growth. It emphasizes the simultaneous advancement of development and environmental preservation. India's environmental framework is built on the idea of sustainable development, which is upheld by its judicial bodies. The Honourable Supreme Court of India has consistently affirmed that the right to a clean environment is fundamental and enshrined in Article 21 of the Constitution.

In India, various principles such as the Polluter Pays Principle, Public Trust Doctrine, Precautionary Principle, and Absolute Liability are applied to achieve two main goals: restoring the environment to its original state as it was before pollution and compensating those affected by environmental harm. Judicial bodies often direct polluting industries to take remedial measures. However, a significant challenge arises due to the prolonged legal proceedings in the Indian Subcontinent, allowing pollution to persist unchecked. However, by the introduction of carbon credit mechanism following things can be achieved.

- a) Developing countries can generate revenue by selling carbon credits to companies with higher demands for fossil fuels.
- b) The carbon trading market operates without direct economic intervention or

government regulation, except for measures aimed at preventing fraud.

c) Threshold limits incentivize industries to adopt alternative energy sources and invest in green technology on a global scale.

IV. INDIA'S NET ZERO STRATEGY

The Long-Term Low Emission Development Strategies (LT-LEDS) are qualitative directives mandated by the 2015 Paris Agreement. According to this accord, nations are required to outline their plans for transitioning economies beyond the initial achievement of near-term Nationally Determined Contributions (NDCs). The overarching objective is to work towards reducing emissions by 45% by 2030 and achieving net zero emissions around 2050.

India's LT-LEDS is founded on four primary considerations. Firstly, despite its significant population share (~17%), India has historically made a minimal contribution to global greenhouse gas emissions. Secondly, India's developmental needs necessitate substantial energy consumption. Thirdly, India is committed to adopting low-carbon strategies tailored to its national circumstances. Lastly, India must prioritize building climate resilience.

The LT-LEDS strategy is also influenced by the LiFE vision (Lifestyle for the Environment), advocating for a global shift from unsustainable consumption patterns to mindful resource utilization.

Key features of the LT-LEDS include a focus on rational resource utilization while ensuring energy security. Transitions away from fossil fuels will be pursued in a just, sustainable, and inclusive manner. The strategy aims to promote the use of biofuels, increase electric vehicle adoption, and expand green hydrogen fuel usage, especially in the transport sector.

India aims to achieve significant milestones, such as reaching 20% ethanol blending in petrol by 2025 and encouraging a modal shift towards public transportation. Sustainable urban development will be prioritized through smart city initiatives, integrated city planning, and green building codes.

The industrial sector will align with the principles of 'Aatmanirbhar Bharat' and 'Make in India.' Efforts will be made to improve energy efficiency through schemes like the Perform, Achieve and Trade (PAT), the National Hydrogen Mission, and increased electrification and recycling.

India is making significant progress in climate action throughout its economy. The country's deep-rooted tradition of respecting nature bolsters societal support for proactive climate measures. India has achieved its voluntary pre-2020 targets, with its policies in line with the 2°C warming limit set by the Paris Agreement. Despite its small contribution to global

emissions, India has consistently made and met ambitious commitments at the UNFCCC and under the Paris Agreement.

The concept of a "Net Zero" target involves achieving carbon neutrality, where a country's emissions are balanced by the absorption and removal of greenhouse gases. India has pledged to achieve net zero emissions by 2070, as announced at the Conference of Parties-26 (COP26) summit.

Building on Prime Minister "Panchamrit" pledges at COP26 in Glasgow, which include reaching net-zero emissions by 2070, India updated its Nationally Determined Contributions (NDC) in August 2022 to:

1. Source 50% of its total installed electric power capacity from non-fossil fuels by 2030.
2. Decrease the emission intensity of its GDP by 45% from 2005 levels by 2030.
3. Promote a healthy and sustainable lifestyle based on traditional values of conservation and moderation, including a mass movement for LiFE (Lifestyle for Environment) to combat climate change.

V. CURIOUS ABOUT HOW CARBON TAX WORKS IN INDIA

India doesn't have a formal cap-and-trade system or direct carbon pricing yet, but it has several programs that indirectly charge for carbon emissions.

The Perform, Achieve and Trade (PAT) plan sets energy reduction goals for industries that use a lot of energy. Industries that exceed these goals earn Energy Saving Certificates, equivalent to one metric ton of oil. Those that fail to meet the targets must buy from those that exceeded their goals on trading platforms managed by the Indian Energy Exchange.

A coal tax introduced in 2010 aimed to fund clean energy research through the National Clean Energy Fund. However, the fund was not used effectively.

In 2017, the Goods and Services (GST) Compensation cess replaced the coal tax to compensate states for revenue losses due to the new tax system.

Renewable Purchase Obligations (RPOs) and Renewable Energy Certificates (RECs) support the growth of renewable energy. Power distribution companies must source a certain percentage of their electricity from renewables. State Electricity Regulatory Commissions set and enforce these obligations. RECs are traded on power exchanges to help meet RPOs.

Many private companies in India, like Mahindra and Mahindra, Tata, Infosys, and Wipro, use internal carbon pricing (ICP) to voluntarily reduce emissions and invest in greener technologies

to meet their sustainability goals.

(A) Carbon Credit

A carbon credit is a permit that allows the company holding such permit to emit a certain amount of carbon dioxide and other green-house gases into the atmosphere.

There are 3 types of carbon credits: -

- 1) Assigned Amount Units (AAU)--The Annex 1 Country as per the Kyoto Protocol is allotted a fixed amount of AAU by the United Nations Framework Convention on Climate Change. The AAU fixes the amount of greenhouse gases that can be emitted into the atmosphere by the Annex 1 Country which in turn distributes them to the industries.
- 2) Emission Reduction Unit (ERU)—In addition to the AAU allotted by the United Nations Framework Convention on Climate Change, a developed country can set up projects in another developed countries that reduces the overall carbon footprints which allows them to earn carbon credits, called the Emission Reduction Unit (ERU).
- 3) Certified Emission Reduction (CER)—It is a carbon credit that involves developing countries which are not a part of the carbon reduction committee. The projects which have the overall effect of reducing the carbon footprints by the developing countries are allotted the CERs by the UNFCCC.

Carbon credits can be exchanged between businesses/entities or it can be bought and sold in the international market at the then prevailing market price. The transaction of carbon credits transaction is done with a good intent and also for executing profitable projects. Therefore, it is natural for every jurisdiction to propose to tax the carbon credits. So, as is the case with India.

VI. INCOME TAX TREATMENT OF CARBON CREDITS

Section 115 BBG of The Income Tax Act, 1961, introduced by the Finance Act, 2017, imposes a 10% tax on carbon credits transactions. This provision aims to deter such transactions. For brevity, here is the relevant section:

“115BBG. (1) Where the total income of an assessee includes any income by way of transfer of carbon credits, the income-tax payable shall be the aggregate of—

(a) the amount of income-tax calculated on the income by way of transfer of carbon credits, at the rate of ten per cent; and

(b) the amount of income-tax with which the assessee would have been chargeable had his total

income been reduced by the amount of income referred to in clause (a).

(2) Notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance shall be allowed to the assessee under any provision of this Act in computing his income referred to in clause (a) of sub-section (1).

Explanation. —For the purposes of this section, "carbon credit" in respect of one unit shall mean reduction of one tonne of carbon dioxide emissions or emissions of its equivalent gases which is validated by the United Nations Framework on Climate Change and which can be traded in market at its prevailing market price."²

This section states that if an assessee's total income comprises income derived from the transfer of carbon credits, it is taxable at a flat rate of 10%. Additionally, no deduction is allowed under any provisions of the Act. The taxation of carbon credits raises the question of whether they are a revenue or capital receipt. While this question is pending before the Supreme Court of India in the *Lanco Tanjore Case*³, various High Courts and the Income Tax Appellate Tribunal have endorsed the view that transactions involving carbon credits qualify as a capital receipt and are not liable to tax.

One such endorsement is the view taken by the Madras High Court in *SP Spinning Mills vs ACIT*⁴, where the main question was whether the sale of carbon credits generates a capital receipt or a profit from the assessee's business activity. The Madras High Court, in addressing this issue, referred to a similar issue regarding loom hours in the case of *Commissioner of Income Tax v Maheshwari Devi Jute Mills Ltd*⁵. In this case, it was decided that the amount received from the sale of loom hours is a capital receipt and not income arising from business operations. The rationale behind this decision was that the sale of loom hours did not occur in the ordinary course of trade, considering the nature of the assessee's business activity, and thus amounted to a capital receipt not subject to tax.

In the case of *M/s Empire Jute Co. Ltd v Commissioner of Income Tax*,⁶ more than a decade later, the question of whether the purchase of loom hours qualifies as a capital expenditure was considered. The Supreme Court rejected the notion that what may be a capital receipt should be considered a capital expenditure, describing this as a "double fallacy." A test of enduring benefit was applied, and it was concluded that the purchase of loom hours did not enhance the

² Income Tax Act, 1961 § 115 BBG, No. 43, Acts of Parliament, 1961 (India).

³ PCIT vs Lanco Tanjore Power Co. Ltd (2021) 434 ITR 671 (Mad.) (HC)

⁴ SP Spinning Mills vs ACIT (2021) 433 ITR 61

⁵ Commissioner of Income Tax vs Maheshwari Devi Jute Mills Ltd [(1965) 57 ITR 36 (SC)]

⁶ M/s Empire Jute Co. Ltd vs Commissioner of Income Tax [(1980) 4 SCC 25]

capital of the enterprise, therefore qualifying as a revenue expenditure.

After analysing the above two judgments, the Madras High Court in the SP Spinning Mills ⁷case, heavily relying on the Andhra Pradesh High Court Judgment on *Commissioner of Income Tax-IV v My Home Power Ltd*, ⁸held that the sale of carbon credit is not a result of business activities but rather a result of environmental concerns. Therefore, it constitutes a capital receipt and is not liable to tax. Currently, the position favours the taxpayers unless the Supreme Court decides otherwise.

(A) GST treatment of carbon credits

According to the GST laws, tax is only applicable to goods or services. Anything that is not classified as "goods" or "services" cannot be subjected to the GST regime. Therefore, the applicability of GST on carbon credits depends on whether they come under the ambit of "goods."

As per Section 2(52) of the Central Goods and Services Tax Act, 2017 (CGST Act), goods “include all types of movable property except money and securities, but includes actionable claims, crops, grass, and items attached to land that are agreed to be severed before supply or under a supply contract.”⁹

On the other hand, Section 2(102) of the Central Goods and Services Tax Act, 2017, defines services 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.”¹⁰

A detailed analysis of "securities" under the CGST Act indicates that carbon credits are not included in this definition. Additionally, the Central Government's Notification No. S.O.3068(E) dated September 27, 2016, declared carbon credits as goods (commodity derivatives) for the purposes of Securities Contract (Regulation) Act.

Furthermore, the Honourable Supreme Court decision in the case of *Tata Consultancy Services vs State of Andhra Pradesh*¹¹ held that it is immaterial whether the goods are tangible or intangible, but the goods must possess attributes like: a) its utility, b) capable of being bought and sold, c) capable of being transmitted, transferred, delivered, stored and possessed.

⁷ Supra.

⁸ Commissioner of Income Tax- IV vs My Home Power Ltd [(2014) 46 Taxmann.com 314 (Andhra Pradesh)]

⁹ Central Goods and Services Tax Act § 2(52), No. 12, Acts of Parliament, 2017 (India).

¹⁰ Central Goods and Services Tax Act § 2(102), No. 12, Acts of Parliament, 2017 (India).

¹¹ Tata Consultancy Services v State of Andhra Pradesh (2004) 271 ITR 401

Additionally, the Central Government's Circular No. 34/8/2018-GST dated March 1, 2018, clarified that priority sector lending certificates (PSLCs) are similar to renewable energy certificates (RECs) and not securities, thus subject to 18% GST under the residual category. Carbon credits are similar to RECs. Another Circular No. 46/20/2018-GST dated June 6, 2018, specified that RECs, PSLCs, etc., fall under heading 4907, attracting a 12% GST instead of 18%.

Considering the above provisions, it can be concluded that carbon credits are subject to a 12% GST, similar to RECs. However, the Ministry of Finance, Department of Revenue, in Notification No. 8/2021-Central Tax (Rate) dated September 30, 2021, increased the GST rate for Heading 4907 to 18% effective October 1, 2021. Thus, transactions involving RECs from this date onward are taxed at 18%. Regarding the export of carbon credits, it is considered a zero-rated supply and hence is not subject to GST

VII. CONCLUSION

The World of today believes in the concept of sustainability which states that development and environment must go hand in hand. The introduction of carbon tax vis a vis the carbon credits within the taxation laws of the country is a right step in the direction of alternative energy or green energy. Taxes have a deterrent effect on the polluting industries/companies in reducing the overall carbon footprints in the environment so that the net zero carbon neutrality can be achieved in 2070 by India in line with the country's international obligations.
