



Confronting the carbon challenge  
Tax implications of the development  
of carbon markets



### Your issue

Demand for the development of markets for regulated emissions across the six types of greenhouse gases continues to grow, driven by pressures on both domestic and international fronts and the steady progress of the Western Climate Initiative (WCI), among other influences. Although the Copenhagen negotiations did not result in firm agreements, many businesses still want to understand how to plan for existing and emerging U.S. and cross-border carbon markets.

### Implications for businesses

What does the evolution of carbon markets mean for businesses? The implications can be significant, including the following:

- Substantial incremental costs for entities in regulated carbon markets.
- Need for organizations to integrate the price of carbon into their overall business strategy.

- Reconsideration of accounting policy elections.
- Potential changes in financial statement accounting and reporting.
- Increased need for tax resources to understand and utilize the various incentive regimes, as well as to address related tax compliance issues.

### Tax issues to consider

Although enactment of federal cap and trade legislation appears stalled, tax issues remain important in planning for a carbon-sensitized world. Furthermore, pressures to reduce carbon emissions will continue as the Environmental Protection Agency steps up its regulatory action. State and regional initiatives to reduce carbon emissions also continue apace, often stemming from public and shareholder pressures, coupled with corporate social responsibility programs. All will continue to provide a strong inducement to invest in alternative energy, reduce carbon output, and encourage energy savings. Until carbon is priced into the cost of end-products such as electricity, government incentives will play an important role in encouraging investments in alternative energy.

Much of the corporate-focused stimulus funds available in 2009 and 2010 were directed toward “clean tech,” alternative energy investments, smart grid, and energy efficiency. Although the rules are clear in some cases, they may not be in others, leaving questions on myriad topics, including:

- Taxability in whole or in part at the income tax level for federal and state purposes.
  - The effect on the basis of property funded, taking into account the timing of purchases and the receipt of the funds.
  - Sales tax implications related to expenditures.
  - Choosing the optimal program consistent with your organization’s objectives, for example, the federal investment tax credit or the production tax credit, etc.
  - Identifying and qualifying for available incentives, given that state incentives are often changing and in flux.
- Increased risk associated with price, credit, operational, and regulatory issues, among others.
  - The need for new governance and organization designs to incorporate new policies and procedures, and internal controls to govern carbon management.
  - The potential impact of carbon prices on contracting and capital allocation decisions.
  - Potential revision of hedging strategies for carbon as a new commodity.

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Should cap and trade legislation regain traction, it will raise a whole host of tax compliance and planning issues. How will emissions allowances be treated upon issuance, purchase, sale, or exchange? How will basis in the allowances be recovered? Are they inventory or a capital asset? Can they be hedged, by whom, and with what treatment? More difficult questions may arise from the creation of offsets, depending on who creates the offsets, where they are created, and for what purpose. A multitude of issues will arise from the global nature of carbon markets and the likelihood of transacting across various states.

As legislation becomes more focused and concrete, tax departments will need to be actively involved at a very early stage to meet their tax compliance needs and manage the tax impact of the carbon emissions activities.

Deloitte can help.

### Our approach

Deloitte's Environmental Sustainability group draws on resources from the many regions, disciplines, and industry groups within Deloitte. Working collaboratively, this group brings to bear the breadth and depth of our understanding, experience, and varied skill sets in the areas of carbon planning and management, sustainability, alternative/renewable energy, energy efficiency, supply chain, and product design/redesign.

With the landscape continuing to evolve, organizations must look beyond the press coverage to understand tax incentives that apply to environmentally sustainable activities and assess the total financial impact of investing in sustainable initiatives. The tax function can help add value to an organization's sustainability projects if it is involved at the front end. Early involvement means more than just the beginning of a project; it means having tax involved when setting objectives, when considering elements as part of the company's data management system for carbon, and when considering alternatives — "go" versus "no go" on sustainable investments.

With regard to carbon markets, our Environmental Sustainability team can help you with a broad range of tax-related matters, including:

- **Global incentive guidance.** We can help you understand the global view of tax incentives — the myriad items included in the tax law providing favorable treatment to encourage sustainable investments, e.g., credits, including the production tax credit, investment tax credits (ITC), grants subsidies, and other government-sponsored benefits associated with carbon and other clean technologies. We also can provide perspective on the research and development credit, accelerated tax deductions, low-interest financing, indirect tax abatements, etc.
- **Development of global tax structures.** We can assist you in developing global tax structures and help you address the tax associated with income from clean technologies' intellectual property. We also can help you establish holding company structures to facilitate ownership of global operations and assist with the implementation of global treasury structures to finance global operations and cash-pooling structures. In addition, we can assist with the structuring of intercompany transactions and transfer pricing documentation.
- **Alternative energy specific guidance.** This support includes structuring and modeling support with a view toward federal, state, local, and international tax incentives, including cost segmentation for grants/ITC, smart grid planning, potential rate-making considerations, etc.
- **Carbon markets specific guidance.** Though carbon legislation is not final and the related accounting treatment is not yet clear, there are many issues to consider related to tax compliance and planning. Our team can advise you on the tax income treatment of allowances and offsets; state planning issues, including transfer pricing; indirect taxes; international tax planning, including pooling strategies, transfer pricing, Subpart F, choice of entity, and jurisdiction arbitrage, as well as tax implications of trading in carbon markets.

- **Information technology (IT) for sustainability.** As companies begin to streamline their processes around the carbon economy and look to software packages to assist with the process of monitoring and reporting, they also are focusing on cost mitigation and, therefore, on IT spend that may benefit from tax incentives. We can help your organization evaluate the tax modules that may be included in software packages you are considering and their fit with your ERP and tax needs. In addition, we can assist with evaluating and implementing systems for managing, monitoring, and reporting on related tax issues of transactions, such as carbon allowance trades.
- **Tax technology and integration.** We can assist with the determination of tax-specific data requirements, as well as integration with ERP and finance systems to help your organization capture requisite information for compliance and incentive requirements.

#### The Deloitte difference

Deloitte has extensive experience in helping organizations understand the complexities of carbon markets — at federal, state, local, as well as cross-border levels — and address the tax implications of the current and developing carbon markets.

To address your organization’s carbon situation and issues, we draw on highly experienced resources from relevant areas, including our [Deloitte Center for Energy Solutions](#), and assemble them into a cohesive team, while providing a single point of contact for ease of communication and management.

Our approach allows us to offer:

- The right mix of technical knowledge and skills for your specific situation and goals relating to carbon management planning and compliance.
- Access to specialists who can help address carbon issues beyond the tax arena, e.g., a national network of real estate construction specialists, environmental liability and reporting specialists, and energy trading specialists.
- A national team with extensive experience in helping organizations effectively address carbon issues, drawing on Deloitte’s deep bench of federal, international, and state and local tax resources.
- Industry perspective, given our breadth of experience serving a wide range of industries, including consumer and industrial products, health care, life sciences, public sector, energy, and technology.

As needed, we also can draw on the experience of the member firms of Deloitte Touche Tohmatsu, with resources in nearly 150 countries, to assist with sustainability efforts wherever you do business — in accordance with local requirements.

#### The Deloitte Center for Energy Solutions

The Deloitte Center for Energy Solutions provides a forum for innovation, thought leadership, groundbreaking research, and industry collaboration to address today’s complex energy challenges.

Through the Center, Deloitte’s Energy & Resources Group leads the debate on critical topics on the minds of executives — from legislative and regulatory policy to operational efficiency to sustainable and profitable growth. Moreover, we provide our clients access to a global network of specialists and thought leaders through the member firms of Deloitte Touche Tohmatsu. To learn more, visit <http://www.deloitte.com/energysolutions>.



## Contacts for more information

### **Brad Seltzer**

Washington National Tax — U.S. and Global Carbon Markets Tax Leader

Deloitte Tax LLP

+1 202 220 2050

[bseltzer@deloitte.com](mailto:bseltzer@deloitte.com)

### **Michael Reno**

Washington National Tax — Alternative Energy Leader

Deloitte Tax LLP

+1 202 378 5027

[mreno@deloitte.com](mailto:mreno@deloitte.com)

### **Jenny Bravo**

National Environmental Sustainability Tax Leader

Deloitte Tax LLP

+ 1 714 436 7554

[jenbravo@deloitte.com](mailto:jenbravo@deloitte.com)

### **Dan Shirley**

Washington National Tax — Multistate, Power/Utilities

Deloitte Tax LLP

+1 412 338 7745

[dshirley@deloitte.com](mailto:dshirley@deloitte.com)

### **Clint Stretch**

Washington National Tax — Legislative Matters

Deloitte Tax LLP

+1 202 879 4935

[cstretch@deloitte.com](mailto:cstretch@deloitte.com)

### **Jeff Clegg**

Tax Partner — International Tax Matters

Deloitte Tax LLP

+1 703 251 1580

[jclegg@deloitte.com](mailto:jclegg@deloitte.com)