

Evolving a policy framework for eco-friendly projects

Source: Mint
July 1, 2009

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Such projects in India are at an exploratory stage; levying a service tax would raise costs significantly

Climate change has far-reaching implications for rapidly developing economies including India. The increased emission of greenhouse gases in the atmosphere disturbs the ecological balance created over millenniums.

The then finance minister, in the speech introducing budget 2008, recognized the impact of climate change and the need for renewable energy although no specific fiscal incentives or rationalization of the fiscal framework was proposed in the Finance Act, 2008. In order to mitigate the impact of greenhouse gases, several steps have been taken to promote green energy and clean development mechanism projects in India.

Promotional measures across various segments include fiscal benefits, capital subsidies, generation-based incentives, purchase obligations, accelerated depreciation, etc. While all these measures are imperative in stimulating investment in green energy and clean development mechanism projects, a well-pronounced fiscal policy is of paramount importance.

Carbon emission reductions (CERs) is a new concept in India. The present income-tax code does not contain an explicit provision for taxation or otherwise of income earned from generation and sale of CERs. Classification of the income from generation and sale of CERs itself is debatable.

One view could be that CERs are earned/generated in the course of carrying on business activities/incidental to the business of the taxpayer, and therefore these should be taxed as business income. An alternative view is to tax the gains on sale as capital gains on the basis that CER is an intangible property and transfer of any property attracts capital gains tax in India. A liberal view could be for exempting the income as a capital receipt. The taxability of income generated on sale of CERs would also depend on the classification of CERs as goods or services. All this creates an immediate need to articulate a tax code for CERs.

With this backdrop, the wish list continues to budget 2009:

The tax holiday currently available to companies engaged in the business of generation, transmission or distribution of power has a sunset clause of 1 April 2010.

With a view to promoting investment in the renewable energy sector, the sunset clause of 1 April 2010 could be done away with. A sector-specific tax holiday for promotion of renewable energy/clean development mechanism projects could be designed.

The tax holiday available to undertakings engaged in collecting and processing biodegradable wastes for a period of five years could be increased to 10 years. Similar tax holiday schemes/benefits could also be formulated for promoting adoption of renewable sources of energy other than in power plants. The benefit of tax holiday could be made more lucrative by providing exemption from payment of minimum alternative tax during the tax holiday period. The section providing for denial of a tax holiday post re-organization of business via merger/demerger could be removed.

Specified plants and machinery in the renewable energy sector are entitled to an accelerated depreciation of 80%. A similar benefit could be extended to machinery employed in clean technologies.

Present fiscal incentives to the renewable energy sector incentivize investment and not generation/production. A generation-based incentive such as tax credit certificates could be introduced that promotes generation rather than investment in this sector.

The Income-tax Act provides exemption from tax including minimum alternative tax to a venture capital fund/ company on income derived from investments in venture capital undertakings. The exemption could be extended to include investments by venture capital undertakings in the renewable energy sector.

Clean development mechanism projects in India are at an exploratory stage and levying a service tax on such projects raises the cost of the project significantly. In order to promote renewable energy projects, service tax could be exempted for input services necessary for setting up as well as operation of renewable power projects.

The long-term potential of the renewable energy sector makes it important for the country to nurture this industry and fiscal policy framework, which is currently in a nascent stage. In evolving the policy framework, India can learn and benefit from the experience of developed countries.