

JR news

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Broadening our horizons

As most readers will be aware, whilst we continue to trade as Johnston Rorke we have now affiliated on a national basis with Pitcher Partners and on an international basis with Baker Tilly International.

Baker Tilly International has offices in over 100 countries throughout the world.

This edition of our Corporate newsletter features an article on Climate Change written by our Melbourne colleagues Graham Noriskin, Ian Stewart and Hamish Mogan.

We hope you find the articles both interesting and informative.

JOHNSTON RORKE
JR
CHARTERED ACCOUNTANTS

Climate change – how will it affect your business?

Climate change and Carbon Dioxide levels

Over the past 800,000 years, carbon dioxide (CO₂) levels, measured in parts per million (ppm) in the atmosphere, have historically fluctuated between 200 and 300 ppm. Interestingly, when CO₂ has been at 200ppm, this has usually been accompanied by a global ice age. The world's climate is extremely sensitive to carbon dioxide levels, and while no one can be absolutely certain, scientists anticipate that an increase to 450 ppm, would cause an increase in global temperatures of around two degrees.



Johnston Rorke – now affiliated with Pitcher Partners nationally and Baker Tilly International internationally

OUR PARTNERS

Bruce Annabel Chris Ball Peter Camenzuli Jason Evans Warwick Face Nigel Fischer Katrina Haiduk Brett Headrick Teresa Hooper Clark Jarrold Ian Jones
Kylie Lamprecht Mark Nicholson Ken Ogden Norman Thurecht Ross Walker

OUR CONTACT DETAILS

Level 30, Central Plaza One 345 Queen Street Brisbane Qld 4001 GPO Box 1144 Brisbane Qld 4001 Phone (07) 3222 8444 Fax (07) 3221 7779

This seemingly small rise in temperature, would cause untold damage to our planet – a third of our species would be lost, there would be a rapid melting of the Greenland and Arctic ice caps and a substantial rise in sea levels. In 2001, the carbon dioxide levels in the atmosphere was measured at approximately 370ppm, and the prediction for 2100 is 670ppm.

This global outlook has caused concern for governments and the public at large who have realised that unless significant and sustainable global action is taken to forestall projected climate change trends, large-scale, irreversible damage to our planet, and its inhabitants, is likely to occur.

Government and Regulatory Policy

The policy and regulatory response of Government to the climate change issue is discussed below:

- **The introduction of the National Greenhouse and Energy Reporting Act 2007(NGER).** The Act establishes a national framework that requires companies who exceed energy production, energy use or greenhouse gas emission thresholds to report annually on their greenhouse gas emissions and energy consumption and production. Thresholds and timelines are:

Facilities	25,000 tonnes or 100 Terajoules		
Corporate Groups	125,000 tonnes emissions or 500 Terajoules energy	87.5kt 350Tj	50kt 200Tj
Corporations to apply for registration	31 August 2009	31 August 2010	31 August 2011
Corporations to provide data report	31 October 2009	31 October 2010	31 October 2011
Government publish the data	28 February 2010	28 February 2011	28 February 2012

kt – 1000 tonnes, Tj- terajoule. Facility – 'single site', part of production process, single industry sector



Measurement of thresholds are to include direct but not embedded emissions or energy contained in materials or services you purchase.

To gain a relative perspective, a small 1800cc car travelling 15,000 km emits approximately 4 tonnes per annum and 1000sqm of office space emits approximately 125 tonnes per annum.

■ Government's Green Paper

The Australian Government released its Carbon Pollution Reduction Scheme Green Paper in July 2008 ('Green Paper'), which sets out the Government's preferred position on emissions trading and the support proposed, to assist households and businesses adjust to the new regime. In addition to the Emissions Trading Scheme, the Green Paper proposes the development of provisions in the income tax law to deal with the acquisition, surrender and trading of emissions permits. This covers tax treatment in relation to the deductibility of the permit cost, deferral of deductions, proceeds on sale of permits, free permits, cash grants, penalty costs for insufficient permits and GST.

It does not address tax incentives for innovation and R&D expenditure on climate change related issues and adjustments to the capital allowance regime to increase incentives to lower emissions through the investment in new plant and equipment.

■ White Paper

On 15 December 2008, the Department of Climate Change released its White Paper detailing the Carbon Pollution Reduction Scheme ('CPRS'). The White Paper provides details as to the framework by which the Government intends to introduce an Emissions Trading Scheme ('ETS') by 2010. In releasing the White Paper, the Government has noted that while the Global Financial Crisis is a considerable threat to the overall prosperity of Australian businesses, it does not diminish the real and credible threat of inaction in the face of Climate Change. The CPRS is intended to face the long-term challenges today in moving Australia towards a 'low pollution economy'.

The CPRS is expected to earn the Government approximately \$12 billion per year, with the vast majority of this revenue provided back to Australian businesses and households in the form of compensation and assistance. Some of this revenue will also be used to provide incentives for energy efficiency.

Targets and Timelines

Australia remains committed to a long term goal of a 60% reduction of emissions levels from those of 2000 by 2050. In achieving this target, the Government has set several interim targets. In the short-term, Australia remains committed to the Kyoto targets up until 2013. In the medium-term, The Government has opted for reductions of emission targets of between 5% and 15% of 2000 levels by 2020. Whilst this has drawn much criticism, The Prime Minister, Mr. Kevin Rudd, has stated that "We are not going to make promises that cannot be delivered."

The 5% reduction will be unconditional, however should the Government be convinced that all major economies commit to substantial reductions in emissions, the 2020 target will be amended to 15% below 2000 levels.

What is Emissions Trading?

The CPRS specifies that in order to achieve the targets and timelines above, an efficient market system is to be implemented in order to provide sufficient incentives for businesses to reduce emissions. The mechanism by which this will be implemented is known as the Emissions Trading Scheme which is a 'cap-and-trade' system that has been adopted by the European Union. Such a system now appears to be the likely international system of choice, following statements made by the incoming administration in the United States, under President Barack Obama, who have stated an intention to implement an "economy-wide cap-and trade system" with an aggressive long term target of an 80% reduction of emissions by 2050.

The system works by imposing a cost on carbon with a permit enabling the holder to emit 1 tonne of carbon dioxide or trade the permit to another business. The number of permits on offer will be gradually reduced in order to meet the targets referred to above, and thus the market will determine the price of each permit.

Allocation of permits will be through administrative allocations to certain industry sectors, and auctioning of the permits in a market.

Initially, The Government intends to cap the price of a permit at \$40 with an increase at CPI + 5% per annum. The majority of opinion as to the average price of permits at commencement in 2010 is approximately \$20-\$25 per permit.

Assistance and Transition Arrangements

The potential of higher costs imposed by this process on business is a considerable risk to some high energy consuming sectors.

The Government intends to reinvest funds raised by the permit auctions to assist households and Australian businesses to adjust to the new regime. The principal mechanism for this will be the Climate Change Action Fund ('CCAF') which will administer approximately \$2.15 billion dollars over a five year period from 2008-2009. The CCAF will assist, amongst other initiatives, the purchase of energy efficient equipment, with some funds available as grants for developing longterm energy efficiency plans. Detailed eligibility criteria for assistance under the CCAF will be made available in the first half of 2009.

The CPRS also proposes to provide assistance in the form of free permits to a number of industry sectors including Emission Intensive-Trade Exposed ('EITE') or Strongly Affected Industries ('SAI')s. Some households will also receive compensation in the form of a payment system and tax relief. This is intended to combat the anticipated inflationary impact on the price of electricity and gas.

Motorists will also be protected from the impact of the ETS on fuel-excise tax through 'cent-for-cent' tax reductions for the first three years of the ETS although this concession applies to other road transport for only one year before being reviewed.

Key Considerations

Whilst the scheme will impose a cost on business, the significant compensation available and comparatively low price of permits will make the cost manageable at least in the short term.

Whilst significant time, effort and money has been invested by The Department of Climate Change in engaging Treasury to model the effects of the CPRS, the level of meaningful detail as to the effect on the SME market is minimal. Consequently, we recommend that businesses take the initiative by assessing their carbon risk by reviewing their supply chain and beginning to understand their energy costs.

Estimates of the likely increase in energy costs vary widely but for electricity and gas the range is from 12% to a high of 18% in 2010, and up to 40% in 2020, however this figure has been disputed. Impacts are therefore best assessed on a multiple scenario or sensitivity basis.

Businesses can also begin to prepare for the introduction of the ETS in 2010. Consideration should be given to the following:

- How much carbon dioxide or equivalent am I emitting per year?
- How much will this cost my business under the ETS?
- What sort of assistance or transitional arrangement are available for my business?
- How can I manage the risk of permit acquisition in a potentially volatile market?

All businesses should conduct an assessment of their own carbon risks in the same way they would consider any other business risk.

What effect on small and medium businesses?

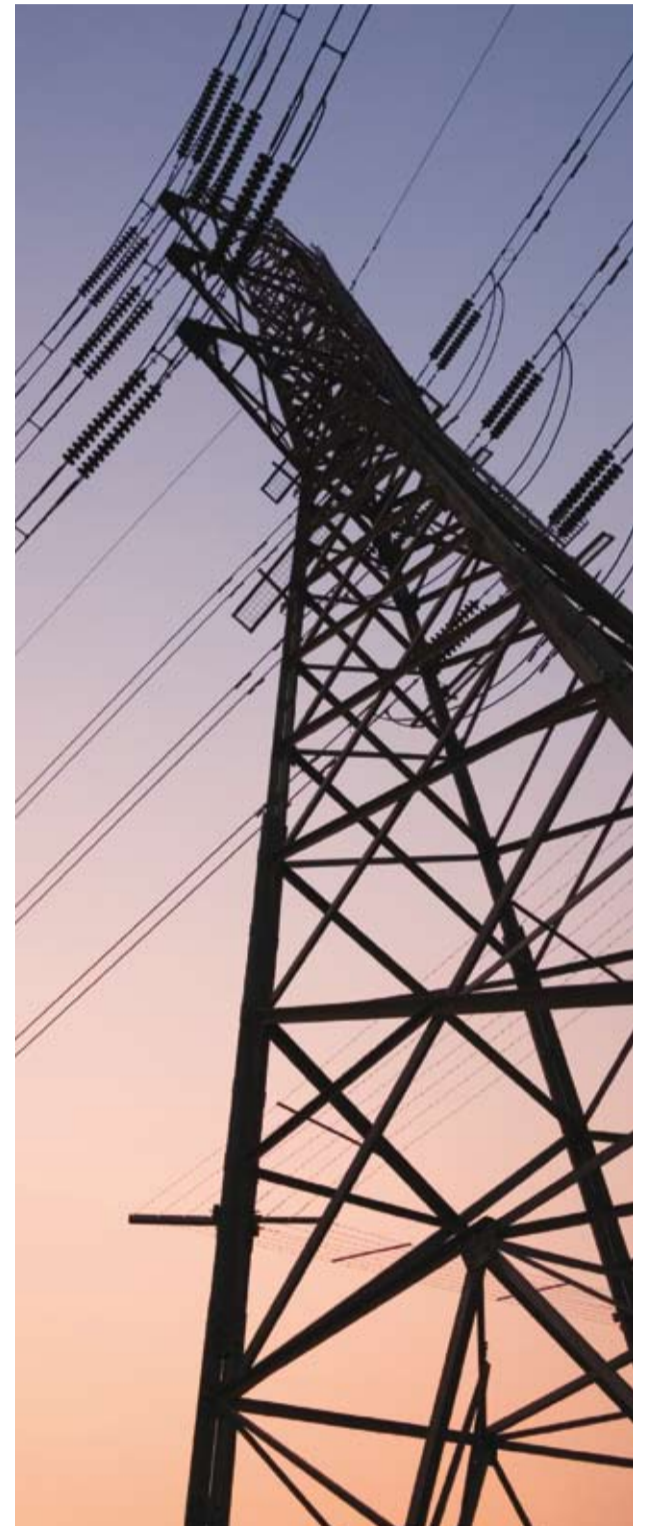
While small and medium sized businesses are unlikely to feel the direct impact of government policy in the immediate future, the indirect effects will be felt reasonably quickly. The downstream flow of government and regulatory requirements will ultimately force small and medium businesses to establish and monitor their carbon footprint.

The major source of emissions for small to medium businesses will be electricity usage, transport and waste.

NGER – While the reporting requirements under the Act are unlikely to directly affect small to medium businesses in the immediate future, there is likely to be an impact from larger companies requesting their suppliers to provide information on their energy and carbon footprints as well as providing sustainability reports. In time, an emissions and energy inventory may be required for every business, as part of the ongoing measurement and reporting of its carbon footprint, somewhat of an environmental equivalent of the GST.

ETS – For most small to medium businesses, it is likely that their emissions will be covered by permits embedded in their purchases. For example, the price of electricity will include the cost of permits, the cost to transport goods will include a permit cost (purchased by the transport company or already embedded in the cost of fuel). In addition to the compulsory ETS, some companies are trading carbon offsets through a voluntary system.

Tax – The tax aspects in relation to permit activities will impact on businesses that have a direct involvement in permit procurement and disposal. Other businesses will have the cost of permits, included in the cost of the goods and services they purchase.



Grants to Business

In an effort to assist businesses, the Government has made and will continue to make available a range of grants. The range and volume of these would be expected to increase, as the climate change agenda grows. Some of the grants which will assist companies conducting research and development and other precommercial activities, include:

- Climate ready – grants from \$50,000 – \$5million for activities that develop innovative products, processes and services that address the negative effects of climate change.
- Re-Tooling for Climate Change – grants from \$10,000 – \$500,000 for energy efficient manufacturing tools, small scale cogeneration plants, and water recycling
- Green Building Fund – grants up to \$200,000 to retrofit and retro commission existing commercial buildings for cost saving energy efficiency measures.

Investment allowance

The Government has released Exposure draft legislation for consultation regarding its previously announced Small Business and General Business Tax Break.

The tax break, in the form of an investment allowance, will provide:

- an additional tax deduction of 30 per cent of the cost of eligible new depreciating assets acquired under a contract, or started to be constructed, after 12.01am AEDT 13 December 2008 and before the end of June 2009 (provided the assets are installed ready for use by the end of June 2010); and
- an additional tax deduction of 10 per cent of the cost of eligible new depreciating assets acquired under a contract, or started to be constructed, between 1 July 2009 and 31 December 2009 (provided the assets are installed ready for use by the end of December 2010).

New expenditure on existing assets may also qualify. For both periods, small businesses will be able to claim the deduction for eligible assets costing \$1,000 or more. Small businesses must have a turnover of less than \$2 million a year to qualify.

For other businesses, a minimum expenditure threshold of \$10,000 applies.

Eligible assets

Assets that are in

The investment allowance will apply to new tangible assets used in carrying on a business for which depreciation is available under the core provisions of the Capital Allowances rules in the 1997 Tax Act.

Expenditures above the applicable threshold which are capitalised into an existing depreciable asset may also qualify for the investment allowance.

In a departure from previous versions of the investment allowance, cars will not be automatically disqualified from the allowance – the only specific restriction this time around is that taxpayers using the ‘cents per kilometre’ method to calculate their allowable car expenses will be excluded from claiming the investment allowance.

Tangible depreciating assets that receive a deduction under the R&D provisions in the 1936 Tax Act may also qualify for the investment allowance.

Assets that are out

As the investment allowance only applies to new tangible assets it will **not be available for intangibles and rights such as computer software.**



Land and trading stock are already excluded from the definition of depreciating assets under the Capital Allowances rules and will not qualify for the investment allowance.

In addition, assets that receive capital allowance deductions outside the core provisions of the Capital Allowances rules are not eligible for the investment allowance. These assets include:

- depreciating assets involved in primary production (including water conservation facilities and horticultural plants);
- capital expenditure of primary producers and other landholders; and
- capital expenditure for the establishment of trees in carbon sink forests.

Similarly, capital works on buildings (for which deductions are available under Division 43 of the 1997 Tax Act) are not eligible for the investment allowance.

Claiming the investment allowance

The investment allowance will be available to the taxpayer who is entitled to the capital allowance deduction under the Capital Allowance rules in respect of the asset.

The investment allowance is on top of the usual capital allowance deduction available for the asset.

The investment allowance is claimable in the income year in which the asset is first used or installed ready for use.

Taxation	Team member	Position	Phone	Email
	Chris Ball	Partner	07 3222 8405	CBall@jr.com.au
	Megan Larsen	Director	07 3222 8444	MLarsen@jr.com.au
	Bernard Naude	Senior Manager	07 3222 8444	BNaude@jr.com.au
	Selina Trace	Senior Manager	07 3222 8444	STrace@jr.com.au
	Adam Gray	Manager	07 3222 8444	AGray@jr.com.au
	Anne Twine	Manager	07 3222 8444	ATwine@jr.com.au
GST	Ken Ogden	Partner	07 3222 8444	KOgden@jr.com.au
	Peter Camenzuli	Partner	07 3222 8444	PCamenzuli@jr.com.au
Audit / Corporate	Ross Walker	Managing Partner	07 3222 8444	RWalker@jr.com.au
	Jason Evans	Partner	07 3222 8444	JEvans@jr.com.au
	Warwick Face	Partner	07 3222 8444	WFace@jr.com.au
	Katrina Haiduk	Partner	07 3222 8444	KHaiduk@jr.com.au
	Clark Jarrold	Partner	07 3222 8444	CJarrold@jr.com.au

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