20 August 2024

Dear Director, International Tax Unit - Corporate and International Tax Division,

RE: Consultation paper on *Strengthening the foreign resident capital gains tax regime*

The Clean Energy Council (CEC) is the peak body for the clean energy industry in Australia, representing nearly 1,000 of the leading businesses operating in renewable energy, energy storage, and renewable hydrogen. The CEC is committed to accelerating Australia's transition to a clean energy future.

SUMMARY

The CEC welcomes the opportunity to comment on the consultation paper on *Strengthening the foreign resident capital gains tax regime*, and the opportunity to provide input and advice on behalf of the clean energy industry.

Recommendation

> The Clean Energy Council respectfully recommends that Treasury should, before proceeding any further with reforms to Australia's capital gains tax (CGT) regime, undertake robust research that explores the impacts CGT reform could have on Australia's transition to net zero, including on the rate of investment in new renewable energy projects and with consideration of how the reforms could help make Australia a more attractive jurisdiction for investing in clean energy to accelerate the net zero transition.

The CEC recognises the proposal arises in response to ongoing uncertainty in Australia's capital gains taxation (CGT) regime, along with the challenge of ensuring CGT rules are clear and fair for all investors. A fair and equally applied tax regime can support a more efficient market for renewable energy because it encourages firms to compete on merits of their projects and offerings. A tax system that favours some entity types over others, such as domestic or non-resident status, can distort the market without concomitant public benefit and also reduce competition. Ultimately such impacts will slow the energy transition and increase costs to consumers.

Given the imperative for transitioning Australia's economy to net zero, encouraging competition, and protecting consumers from further rises in energy costs, the CEC supports clarity and fairness in Australia's CGT regime. Recognising that approximately 75 per cent of capital to finance Australia's net zero transition comes from foreign direct investment, the CEC also appreciates that Treasury faces unique and complex challenges to design and implement CGT reforms and ensure those support, or at least do not counteract, the Government's efforts to accelerate the net zero transition, ensure adequate electricity supply, support the Future Made in Australia (FMIA) Act, and provide Australians relief from rapidly rising costs of living.

Because these matters are so important, especially the need to accelerate Australia's net-zero transition, the CEC sees significant risks with the proposal to extend the definition of taxable Australian real property (TARP) to include renewable electricity infrastructure and urges careful and detailed research to understand the potential impact any changes could have on the clean energy industry and net zero transition prior to proceeding further with this change. Without careful consideration and implementation, CGT reforms risk worsening Australia's already difficult investment environment. Done well, though, CGT reforms could unlock more foreign and domestic investment.

THE PROPOSAL RISKS INCREASING COSTS, MISSING TARGETS, AND ERODING ADEQUACY OF POWER SUPPLY

Following from consultation across the industry, the CEC considers that the proposed changes risk further slowing investments in renewable energy in Australia at a time when the country needs to accelerate them. Figure 1 shows how investment levels have slumped since 2018. While the CEC is hopeful that current efforts by the Federal and state governments will help address key barriers to investment and support arresting and reversing the decline, investment conditions today remain very challenging. Financial investment commitments for new generation remain well below the 6-7GW per annum required to achieve the Government's target of 82 per cent by 2030. This is one basis for the CEC's concern about any policy changes which could negatively impact the business case for new investment, and thus work against the positive policy agenda that the Australian Government has been pursuing in this year's budget and more broadly.

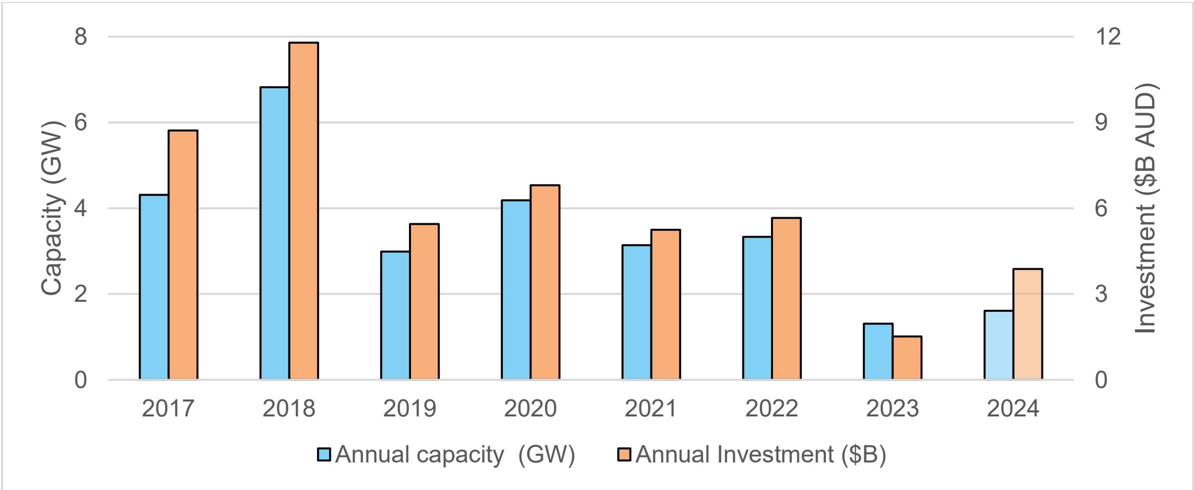

Figure 1: Annual capacity and investment in Australian renewable power generation projects reaching financial investment decision (FID)

A 2023 report estimated that even if the investment and build trend were to reverse the downward trend and increase at a modest pace, Australia could expect to meet only about 46 per cent of its power needs from renewable sources by 2030 – significantly below the Government's target.[1]

The critical roles of foreign investment for transitioning to net zero

To date, approximately 75 per cent of investment in renewable energy has come through foreign direct investment. If investment levels can be raised to meet the Government's renewable energy and emissions targets, inbound capital flows will also need to increase.

Worryingly, in the face of the need for increasing investment, new capital flows look poised to drop in response to the proposed CGT changes. Several of the CEC's large investment and project development members have communicated that they hold highly advanced projects within

[1] "Bridging the Gap to 82% Renewable Electricity Generation by 2030," Clean Energy Council and Green Energy Markets (August 2023).

their Australian portfolios which will no longer proceed under the introduction of a 30 per cent CGT, as they will no longer meet the internal rate of return requirements for new investments. While the total number and size of projects that would be cancelled across Australia is not known, the CEC considers that the Government should be deeply concerned about any further decline in the deployment of large-scale renewable energy generation and storage plants.

Australia already struggles to compete for capital

This change also comes into a business and investment environment where Australian *and* foreign renewable energy investors and developers regularly report how challenging they find Australia compared to other Organisation for Economic Cooperation and Development (OECD) countries and peer nations, plus many other jurisdictions throughout the rest of the world. Various challenges cited as barriers to investing in renewable energy projects in Australia include:

- High uncertainty, complexity and costs to connect new plants
- Stamp duties
- Land taxes, rates, and levies
- Labour costs
- Rising equipment costs as suppliers withdraw from Australia,
- High corporate tax rates,[2] and
- The comparatively high, and rising weighted average cost of capital.

By comparison, other OECD countries and non-OECD advanced economies have more favourable policy environments, including taxation systems, that result in lower costs and greater certainty for global investors. In particular, in Canada, the United Kingdon (UK), the United States (US), Germany, and the Netherlands have effective capital gains taxes on clean energy assets of zero or below.

For example, while the United States has a statutory capital gains tax rate of 21 per cent, it has had a long history of *negative* effective marginal tax rates (EMTR) for renewables on account of specific tax rules including depreciation rates, production tax credits for generating renewable power, and investment tax credits.[3] Combined with the common OECD practice of treating renewable energy assets as not taxable real property, the Congressional Research Service estimates that the Inflation Reduction Act decreased the most favourable EMTR from -114 per cent to -145 per cent.[4]

Other OECD countries, such as the UK and Canada, also have lower statutory rates (25 per cent and 15 per cent, respectively) for capital gains. Quite similar to the US, once coupled with incentives for renewable energy, their EMTRs fall to 0 per cent or lower.

Renewable energy investment is rising in the rest of the world

Evidence of Australia's struggle to attract investment into new renewable energy infrastructure can also be seen by comparing Australia's overall decline in annual investment since 2018 with the global trend of increases in annual investment since 2017, as shown in Figure 2, below.

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[2] Australia's effective corporate tax is the second highest among OECD nations. See Corporate Tax Statistics Database | OECD.

[3] Commencing with the Energy Tax Act of 1978. See "The Energy Credit or Energy Investment Tax Credit (ITC)," Congressional Research Service (23 Apr. 2021).

[4] Molly F. Sherlock, "Effective Marginal Tax Rates on Energy-Related Capital Investments: Effects of the Investment Tax Credit and Accelerated Depreciation," Congressional Research Service (15 Dec. 2021).

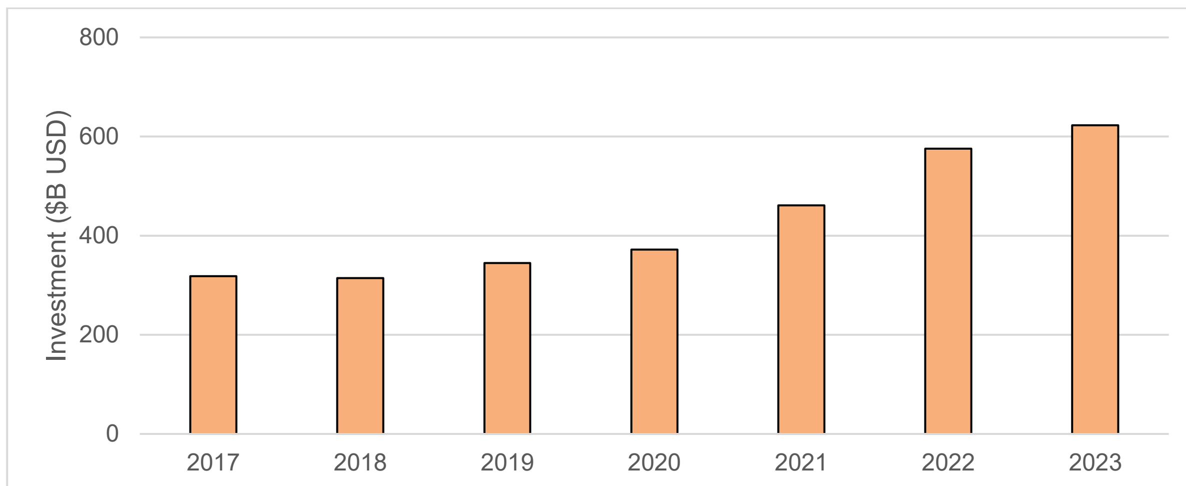

Figure 2: Annual investment in renewable power generation projects reaching financial investment decision (FID) around the world, 2017 through 2023

Change of laws risk
In addition to the increasing costs of projects in Australia, over the last several months, industry stakeholders have begun to express concerns regarding change of laws risk. They have explained that the relatively high number of costly changes to matters such as access rights, levies, rates, duties, and taxation – including this proposal – made on short notice and introduced without early industry consultation have led to a growing view that Australia no longer offers a stable policy and investment environment. Considering these negative changes in Australia, and favourable changes in other countries, these stakeholders' boards and investment committees are increasingly preparing to reduce their exposure to the Australian market, with some considering exiting Australia altogether.

Many of these are infrastructure investors that play an important role in the early stages of the full investment pipeline: they de-risk projects at the development and construction stages that then allows other investors to enter the market at later stages of the pipeline. Because they come in earlier in the pipeline, their business models rely more heavily on capital gains. This means they will get hit the hardest with cost increases, and that will translate into an outsized impact of cancelled and delayed projects over time, resulting in a diminished pipeline of new projects.

Risk of price increases and reliability of supply
In addition to meeting energy and emissions targets, accelerating deployment is critical to maintaining the reliability of supply from Australia's electricity systems as the country's fleet of coal fired power generation reaches the end of its life and the reliability of these ageing power plants decline. Simply put, if new investment is materially delayed such that adequate new supply does not come in as the ageing and uneconomic coal plants retire, the system could ultimately suffer supply shortfalls and challenges to maintaining overall reliability of supply, which in also result in price increases.

FURTHER INDUSTRY ENGAGEMENT

The CEC welcomes and encourages Treasury's engagement with industry to conduct careful and detailed research into the potential impact any changes to the CGT regime could have on the clean energy industry and net zero transition, and collaboration to develop a solution that will ensure fairness in the tax system while supporting the Future Made in Australia Act's aims and ultimately improving Australia's business case for domestic and foreign investment in its net-zero transition.

Given the significant risks this could pose to both of those, the CEC urges extreme caution in proceeding any further with this change and welcomes the opportunity to discuss this with you further.

Further queries can be directed to Paul Beaton at the CEC on
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Yours sincerely

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