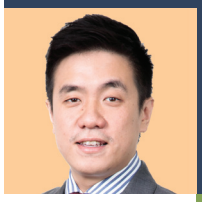
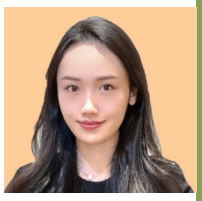
Carbon Tax: What We Can Learn from Other Jurisdictions





by Jason Tan Jia Xin and Ong Lee Min

On 27 September 2021, the Prime Minister tabled the 12th Malaysia Plan (**12MP**, a development roadmap for 2021-25) in Parliament. Among others, key points included the implementation of a carbon tax as Malaysia intends to become a carbon-neutral nation by 2050. If carbon tax legislation is enacted, issues relating to the scope of the taxes, persons liable to register as well as the constitutionality of the law might come to light. The latter was recently tested by the Canadian Supreme Court in *References re Greenhouse Gas Pollution Pricing Act*,[1] a decision that will give us some guidance given that the Malaysian Constitution is strongly underpinned by the concept of federalism and separation of powers.

Malaysia's pledge in carbon reduction

In 2020, Malaysia was found to be the second-largest emitter of carbon dioxide (CO2) in the Asean region. Between 1971 and 2020, CO2 emissions of Malaysia grew substantially from 14.7 to 262.2 million tonnes.[2] The data delineates a worrying sign as CO2 is the primary contributor to the increased global air temperature, upper oceanic warming, pollution and degradation of resources such as air, water and soil. These are factors that directly lead to the irreversible global climate crisis.

In combating the climate change issue, Malaysia signed the Paris Agreement in 2015. In its Nationally Determined Contribution (NDC) to the goals outlined in the Paris Agreement, Malaysia is committed to reducing its carbon intensity by 45% in 2030.[3] The government has taken several adaptation and mitigation measures, including developing the National Policy on Climate Change and national climate projection models, promoting renewable energy and sectoral policies.[4]

The 12MP sets an ambitious goal for the country to achieve net zero carbon emission by 2050, ahead of neighbouring countries like Singapore and Indonesia. Among other carbon pricing approaches, the Prime Minister assertively announced that a carbon tax is included in the 12MP and that a comprehensive National Energy

1 2021 SCC 11
2 Statista Research Development, CO2 Emissions ASEAN 1960-2020, by country (2020)
3 Malaysia's Update of Its First Nationally Determined Contribution to UNFCCC (July 2021)
4 The sectoral policies are related to transport, energy, waste, land use, forestry and agriculture

Policy will be introduced to outline the strategic long-term direction in supporting the country's carbon-neutral aspiration. However, experience from both developed and developing countries strongly suggests that Malaysia will have to implement carbon pricing policies to help achieve its carbon reduction target.

Carbon tax legislation in other Commonwealth jurisdictions

Many jurisdictions have implemented laws and regulations in respect of carbon pricing. Singapore is the first Southeast Asian country to impose carbon tax through its Carbon Pricing Act 2018 (**CPA**). The CPA stipulates that a person must apply to be registered under the Act where the total amount of reckonable greenhouse gas (**GHG**) emissions of his or her business facility has a CO2 equivalence that attains the first emissions threshold of 2,000 tCO2e or higher, while the business facility is under the operational control[5] of that person. In the meantime, that person will be obliged to register that business facility as its reportable facility. In the event that the CO2 equivalence of the total amount of reckonable GHG emissions from the business facility attains the second emissions threshold of 25,000 tCO2e or higher in the same trigger year, that person will need to register the business facility as its taxable facility.

Reports have shown that there are at least 40 companies in Singapore that have exceeded this threshold, and therefore had to register as a taxable facility. According to the legislation, a business facility means a single site at which the business activity is carried out, and the business activity will need to involve the emission of GHG. For Canada, the reporting threshold for GHG emissions under the Greenhouse Gas Pollution Pricing Act (**GGPPA**) is 10,000 tCO2e.

GHGs that are captured within the Singaporean and Canadian legislations include CO2, methane, nitrous oxide, sulphur hexafluoride, nitrogen trifluoride, certain hydrofluorocarbons and perfluorocarbons. Pursuant to the CPA, carbon tax is charged on the total amount of reckonable GHG emissions of a taxable facility of a registered person in a reporting period. No carbon tax will be charged if the amount of GHG emissions in the relevant reporting period does not attain the second emissions threshold. The carbon tax rate is currently fixed at SGD5 per tCO2e. Accordingly, the amount of chargeable carbon tax can be calculated by multiplying the CO2 equivalence of the total amount of GHG emissions with the carbon tax rate. Under the GGPPA, the tax is based on the carbon emissions from combusting the fuel or waste and is set to start at 10 CAD per tCO2e in 2019 and rise by 10 CAD per tCO2e each year until it hits 50 CAD per tCO2e in 2023.

Any registered person who fails to make the full payment of the tax by surrendering the carbon credits or in the form and manner required by the Agency,[6] within the prescribed timeframe, will be subject to a financial penalty of five per cent of the amount of tax assessed and remaining unpaid, is payable in addition to the tax that remains unpaid. Under the GGPPA, any

5 Having the authority to introduce and implement the operating policies, health and safety policies, and environmental policies
6 The Singaporean National Environment Agency established by the National Environment Agency Act

person that fails to file a return for a reporting period as and when required would be liable to pay a penalty equal to the sum of an amount equal to one per cent of the total of all amounts, each of which is an amount that is required to be paid for the reporting period.

The Singapore legislation also provides that each carbon credit captivates a value of SGD5. In essence, carbon credit is used or surrendered for the payment of carbon tax by the registered person for the relevant reporting period. It cannot be sold, transferred, assigned, disposed of or dealt with

If a similar model and scope is adopted in Malaysia's legislation, companies with a high carbon footprint or energy-intensive industries, such as the energy and transport sectors, are likely to fulfil the eligibility for registration. The energy and power industries, which include but are not limited to petroleum refinery, mining, electricity and gas, were found to have emitted 39.6 per cent of GHG in 2019. Meanwhile, the transportation sector accounted for almost 29 per cent of the total fossil fuel combustion in Malaysia. As a matter of course, other companies that do not fall within these industries that would have attained the prescribed emissions thresholds will be equally liable to register. On that account, Malaysian companies or foreign companies with physical operations in Malaysia that produce GHG in the course of their business activities might need to start thinking about harnessing the necessary technology for tracking and reporting their GHG emissions, as well as for calculating their tax liabilities, to ensure compliance.

Over in the UK, the Climate Change Act 2008 limits the use of carbon units[7] whereby the Secretary of State has a duty to set a limit on the net amount of carbon units that may be credited to the net UK carbon account for each budgetary period. In Australia, the Clean Energy Act 2011 requires selected entities to surrender one emissions unit for every tonne of CO2 equivalence that is being produced and released into the atmosphere.

Recently, the Malaysian government approved the proposal of the Ministry of Environment and Water (KASA) to develop a domestic emissions trading scheme (DETS) alongside a Voluntary Carbon Market (VCM) guide for state government authorities and the private sectors to execute carbon credit transactions at the domestic level. It is anticipated that state governments and private sector involved will have the obligation to report on their carbon projects.

Constitutionality of carbon tax legislation — Analysis of Canadian Federal Court's decision

The GGPAA in Canada was thrown into the limelight recently when its constitutionality was challenged. In essence, the GGPPA sets the minimum national standards of GHG price stringency to reduce GHG emissions. In the landmark case of *References re Greenhouse Gas Pollution Pricing Act*,[8] the three Canadian provinces of Alberta, Ontario and Saskatchewan challenged the GGPPA on the basis that it is not within the federal jurisdiction or, in other words, is unconstitutional.

In Canada, when the federal and provincial legislatures seek to pass legislation, they must have legislative powers under s 91 or s 92 of the Constitution Act 1867 (**CA**). Section 91 specifies the subject matters governed by the federal government, whereas s 92 sets out the subject matters exclusively governed by the provincial governments. There are three main branches to the Peace, Order and Good Government (**POGG**) clause in s 91 — emergency branch, gap or purely residual branch and national concern branch. For comparison, Schedule 9 of the Malaysian Federal Constitution comprises three separate legislative lists. The Federal List sets out matters controlled by the federal government, whereas the State List describes those controlled by the state governments. The Concurrent List sets out matters controlled by both federal and state governments.

In *References re Greenhouse Gas Pollution Pricing Act*,[9] the argument on the national concern branch prevailed in the Ontario and Saskatchewan Courts of Appeal, but not in the Alberta Court of Appeal (**ABCA**). The breadth of the GGPPA formed a key basis of the majority's decision in the ABCA. The GGPPA was described as a "constitutional Trojan horse" consisting of a wide ranging discretionary power that the federal government has reserved for itself. The ABCA stated in its judgment that, in a constitutional analysis, the court has to first assess whether the subject matter falls within one of the province's enumerated grounds of legislative power or within the province's proprietary rights as owners of the natural resources. If it does, the national concern doctrine will have no application.

Section 92(16) of the Canadian Constitution Act provides provinces with jurisdiction over generally all matters of a merely local or private nature in the province. While the provinces' residuary powers are included as part of the list of powers under s 92, that in no way affects its residuary nature. In other words, s 92(16)

7 A unit representing a reduction in an amount of GHG emissions the removal of an amount of GHG from the atmosphere, or an amount of GHG emissions allowed under a scheme or arrangement imposing a limit on such emissions

8 *Supra* n 1

9 *Ibid*

is an additional listed power which does not diminish or subsume the other enumerated powers of the provinces. The ABCA concluded that only when the matter would originally have fallen within the provinces' residuary power under s 92(16) does the national concern doctrine have any potential application. The national concern doctrine has no application to matters within the provinces' exclusive jurisdiction under other enumerated heads of power under s 92 or s 92A, and it cannot be used to assign a new head of power to the federal government where the subject matter falls squarely within the exclusive jurisdiction of the provinces.

The other principle relied on by the ABCA is that the GGPPA failed the singleness, distinctiveness and indivisibility criteria. For a matter to qualify as a matter of national concern, it must have singleness, distinctiveness and indivisibility that clearly distinguishes it from matters of provincial concern and a scale of impact on provincial jurisdiction that is reconcilable with the fundamental distribution of legislative power under the Constitution. The intrusion upon provincial autonomy that would result from empowering Parliament to act is balanced against the extent of the impact on the interests that would be affected if Parliament were unable to constitutionally address the matter at a national level.

The matter of a new head of federal power under the national concern doctrine cannot be an aggregate of powers but must rather possess a degree of unity that makes it indivisible and distinct from provincial matters. The ABCA found that the matter is merely an aggregate of powers—virtually all provincial. The regulation of GHG emissions within a province falls within provincial powers under s 92A and s 109 and a number of heads of power under s 92. As a result, neither the fact that GHG emissions transcend provincial boundaries nor the concept of minimum national standards constitutes an indivisible and distinct matter.

Overturning the ABCA's decision, the Supreme Court relied on the branch of national concern and reached the conclusion that the GGPPA is constitutional because the federal government has jurisdiction to pass the carbon tax legislation as a matter of national concern. Sections 91 and 92 of the Constitution give expression to the principle of federalism and divide legislative powers between Parliament and the provincial legislatures. Courts, as impartial arbiters, are charged with resolving jurisdictional disputes over the boundaries of federal and provincial powers on the basis of the principle of federalism. The court has favoured a flexible view of federalism, best described as a modern cooperative federalism, that accommodates and encourages intergovernmental cooperative efforts.

The review of legislation on federalism grounds therefore consists of a two-stage analytical approach. The court must first consider the purpose and effects of the challenged statute or provision with a view to characterising the subject matter or the "pith and substance". The court must then classify the subject matter with reference to the federal and provincial heads of power under the Constitution.

At the first stage, the Supreme Court was of the impregnable view that the pith and substance of the GGPPA fulfils the national concern test as it serves as a national backstop to give effect to the purpose of the federal government to ensure that GHG pricing applies broadly and consistently across the nation. The Supreme Court was also of the view that the double aspect doctrine takes on particular significance. The federal and provincial governments are both free to legislate in relation to the same fact situation but the federal law is paramount. The court must be satisfied that the federal government de facto has a compelling interest in enacting rules over the federal aspect of the activity at issue and that the multiplicity of aspects is real and not merely nominal. Further, the critical element of the constitutional analysis is the requirement that matters of national concern be inherently national in character, not that they be historically new.

Finding that a matter is one of national concern involves a three-step analysis. Firstly, in relation to the threshold question, the federal government must establish that the matter is of sufficient concern to the country as a whole to warrant consideration as a possible matter of national concern. In relation to the threshold question, the federal government has adduced evidence which clearly shows that establishing minimum national standards of GHG price stringency to reduce GHG emissions is of sufficient concern to the government as a whole that it warrants consideration in accordance with the national concern doctrine.

Secondly, in respect of the singleness, distinctiveness and indivisibility test, GHG emissions are predominantly extra-provincial and international in their character and implications, due to their nature as a diffuse atmospheric pollutant and their effect in causing global climate change. Further, the minimum national standards of GHG pricing relates to a federal role in carbon pricing that is qualitatively different from matters of provincial concern, as it operates in a way which seeks to alter individual and corporate behaviour by internalising the cost of climate change impacts. The Supreme Court stressed that federal jurisdiction should be found to exist only where

the evidence establishes provincial inability to deal with the matter. In this instance, the provinces, acting alone or together, are constitutionally incapable of establishing minimum national standards of GHG price stringency to reduce GHG emissions. Besides, failure to include one province in the scheme would jeopardise its success in the rest of Canada. Accordingly, a province's failure to act or refusal to cooperate would have grave consequences for extra-provincial interests.

Thirdly, the federal government must show that the proposed matter has a scale of impact on provincial jurisdiction that is reconcilable with the division of powers. This is because the purpose of the national concern analysis is to identify matters of inherent national concern — matters which, by their nature, transcend the provinces. Although the matter has a clear impact on provincial jurisdiction, its impact on the provinces' freedom to legislate and on areas of life that would fall under provincial heads of power is qualified and limited. First, the matter is limited to GHG pricing of GHG emissions — a narrow and specific regulatory mechanism. Second, the matter's impact on areas of life that would generally fall under provincial heads of power is limited. Although this restriction may interfere with a province's preferred balance between economic and environmental considerations, it is necessary to consider the interests that would be harmed — owing to irreversible consequences for the environment, for human health and safety and for the economy.

At the second stage, s 91 of the Constitution Act states that Parliament can pass legislations for the POGG of Canada in relation to all matters not coming within the classes of subjects assigned exclusively to the provincial legislatures. A matter that falls under the POGG power necessarily does not come within the classes of subjects enumerated in s 91 and s 92. This does not mean that the word "matter" has a different meaning in the context of the POGG power. "Matter" is used in s 91 and s 92 to refer to the pith and substance of the legislation. Nothing in the Constitution supports the construction of a class of subjects under the POGG power that is broader than the matter of the statute. Instead, the Constitution supports the approach of applying the national concern test to the matter of the statute.

The principle of federalism is adamantly emphasised in this case. Likewise, federalism is deeply rooted in the Malaysian Constitution. The principle of constitutional supremacy is boldly proclaimed in Art 4 of the Federal Constitution as "the supreme law of the Federation and any law passed after Merdeka Day which is inconsistent with this Constitution shall, to the extent of the inconsistency, be void". More notably, Art 75 of the Federal Constitution states that if any state law is inconsistent with a federal law, federal law shall prevail and state law shall, to the extent of the inconsistency, be void. However, it remains to be seen to what extent the principles established in *References re Greenhouse Gas Pollution Pricing Act*[10] in relation to the constitutionality of carbon pricing legislation would apply if one comes into force in Malaysia.

Concluding remarks

The Malaysian government could adopt a similar structure to the Singaporean CPA, especially on the scope of the taxes and persons liable to register. In the event that issues of constitutionality arise, the Supreme Court of Canada's decision in *References re Greenhouse Gas Pollution Pricing Act*[11] would shed some light for the legislature and judiciary. The government should also provide compliance guidance to the public and affected industries, especially small and medium-sized enterprises and individuals, who would fall within the ambit of the legislation, if enacted. **LH-AG**

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10 *Supra* n 1
11 *Ibid*