Shepstone & Wylie ATTORNEYS

Presentation to National Association for Clean Air

CARBON TAX BILL

Introduction

- In November 2015, the National Treasury published the Draft Carbon Tax Bill. South Africa has committed to reduce greenhouse gas (GHG) emissions below 34% by 2020 and 42% by 2025.

- According to Treasury, carbon tax seeks to price carbon by obliging the polluter to internalise the external costs of emitting carbon, and to contribute towards addressing the harm caused by such pollution.

- The carbon tax would make an important contribution towards reaching South Africa's Nationally Determined Contribution commitments under the recently ratified Paris Agreement for the emission to peak in 2020 to 2025, plateau for a ten year period from 2025 to 2035 and decline thereafter.

Carbon Tax Design

- In summary, the key points of the design features of the carbon tax include:
  - A basic 60% tax-free threshold during the first phase of the carbon tax, from implementation date up to 2020
  - A 10% tax-free allowance for process emissions to provide relief for industries where the chemical processes inherent in the industry are fixed and there is therefore limited scope for taxpayers reducing GHG emissions
  - A 10% tax-free allowance for trade exposed sectors (industries where exports account for a significant portion of total revenue)
  - Recognition for early actions and /or efforts to reduce emissions that beat the industry average in the form of a tax-free allowance of up to 5 per cent;
  - A carbon offsets allowance of between 5% and 10% which allow taxpayers to reduce their carbon tax liability by investing in South African based approved carbon mitigating projects
  - To recognize the role of carbon budgets, an additional 5% tax free allowance for companies participating in phase 1 (up to 2020) of the carbon budgeting system

Carbon Tax Design Cont.

- The combined effect of all of the tax-free thresholds will be capped at 95 per cent; and an initial marginal carbon tax rate of R120 per ton CO2-e (carbon dioxide equivalent) will apply.

- However, taking into account all of the above tax-free thresholds, the effective carbon tax rate will vary between R6 and R48 per ton CO2e. These tax-free exemptions will range between 60% and 95% of total emissions. This implies that the carbon tax will be imposed on only 5% to 40% per cent of actual emissions during the initial period.

- The initial phase of the carbon tax is intended to end in 2020, after which the percentage-based tax-free allowance could be replaced with an absolute tax-free threshold. This tax-free threshold may be aligned with carbon budgets.

Carbon Offsets

- The draft Regulations on the Carbon Offsets were published on 20 June 2016 which set out the procedure for claiming the carbon offset allowance and for the use of carbon offsets by taxpayers to reduce their carbon tax liability.

- Carbon offsets are investments in specific projects that reduce, avoid or sequester emissions. It is an external investment that allows a firm to access GHG mitigation options at a lower cost than investment in its current operations.

- It is envisaged that at the initial stages of the carbon offset scheme, carbon offsets will only be able to be generated by an approved project.

- The approved projects are as follows:
  - Clean Development Mechanism (CDM) project;
  - Verified Carbon Standard (VCS) project ;or
  - Gold Standard (GS) project.

  CDM, VCS and GS are existing accepted international carbon offset standards, each with their own associated institutional and market infrastructure.

Eligibility

- An offset will be allowed in respect of any Certified Emission Reduction (CER) derived from the furtherance of an approved project that is carried on by a taxpayer on or after 1 January 2017, if that project is wholly undertaken in South Africa and if that project is in respect of an activity that is not subject to the carbon tax.
- In other words, projects that generate carbon offset credits must occur outside the scope of activities that are subject to carbon tax.

- Furthermore, projects registered prior to 1 January 2017 will have to meet certain conditions to be eligible under the scheme.

- Projects benefiting from other government incentives are excluded as this could result in a doubling of the emission reduction benefits and financial incentives for the project. The incentive programmes will include, but are not limited to, projects registered for the Energy Efficiency Savings Tax Incentive (in terms of section 12L of the Income Tax Act, 1962) and the Renewable Energy Independent Power Producers Procurement Programme (REIPPPP).

Procedure for Claiming Allowance

- A taxpayer that intends to utilise an offset as a carbon tax allowance must register that offset with the Administrator at the Department of Energy.

- The taxpayer will be issued with a carbon credit, which are deposited into a registry.

- The taxpayer will be required to obtain an offset certificate which will specify the emissions reductions and will be crucial for taxpayers in order to offset their carbon tax liability.

- Entities liable for carbon tax will have to surrender their carbon offset credits to SARS should they wish to use the offset credits to reduce their carbon tax liability. If SARS decides to carry out an audit or a specific carbon tax liable entity, the Dept of Energy will work with SARS to provide information on the offset credits used by an entity to reduce its tax liability. This will be achieved through providing SARS access to the offset registry/database, which should contain proof of retirement of the carbon offsets

Who will be affected?

- The proposed carbon tax covers the following:
  - fossil fuel combustion emissions (e.g. from engines, boilers, furnaces, etc);
  - fugitive emissions (e.g. from coal mining and oil and gas extraction); and
  - industrial processes and product use emissions (e.g. from chemical or physical processes).

- Thus, sectors that will be most affected include the electricity, mining and manufacturing sectors. The agriculture, forestry and land-use as well as waste sectors are exempt.

Commentators

- Treasury recently published a ‘modelling report’ which results suggests that the carbon tax will have a significant impact on reducing South Africa’s GHG emissions and would lead to an estimated decrease in emissions of 13 to 14.5 per cent by 2025 and 26 to 33 per cent by 2035 compared with business-as-usual.

- The Organisation Undoing Tax Abuse (OUTA) do not believe that the Treasury’s Carbon Tax initiative will help to reduce GHG emissions in the medium to long term. It is their view that the structure of the Carbon Tax Bill, which they say is not ring fenced and directed to support or generate initiatives to combat GHG, will merely become another tax added to the general fiscus.

THANK YOU