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South Africa's Carbon Tax Bill

This Quick Brief originated from a fascinating presentation given by Dr Laurraine Lotter from Business Unity South Africa (BUSA) recently at a National Business Initiative (NBI) member event in Sandton, Johannesburg.

Globally, there are two primary policy instruments being used to drive down carbon emissions: a carbon tax and an emissions trading scheme. Countries like the UK, Netherlands and Finland have put in place a carbon tax whilst others such as China, the European Union and States within the USA have been using an emissions trading scheme.

The end goal for these policy instruments is to reduce absolute carbon emissions per country, in line with their Nationally Determined Contributions (NDC) submitted to the UNFCCC.

In South Africa, government has decided upon a carbon tax as well as a carbon budget approach per sector, with the carbon budgeting process currently voluntary for key emitters. In December 2017 National Treasury published an updated draft Carbon Tax Bill for public comment, with the deadline of 9 March 2018. Published expectations are that the revised Carbon Tax Bill will be formally tabled in Parliament in mid-2018, and come into effect from 1 January 2019.

The key design features of the carbon tax bill include the following:

- The tax will be phased in over a period of time to allow for smooth transition in adopting cleaner and more efficient technologies and behaviours. The first phase will run from implementation up to 2022.
- The initial marginal carbon tax rate will be R120 per tonne of CO_2e (carbon dioxide equivalent), which will increase at CPI + 2% until 2022. Taking into account the thresholds mentioned below, the effective tax rate is much lower and ranges between R6 and R48 per tonne.

- To allow businesses to adapt and transition to low carbon alternatives in the first phase a basic percentage based threshold of 60% will apply below which tax is not payable. The following additional tax-free allowances apply:

    - An additional 10% for process emissions;
    - An additional allowance for trade exposed sectors, to a maximum of 10%;
    - An additional allowance of up to 5% based on performance against emissions intensity benchmarks. These benchmarks will be developed in due course;
    - A carbon offsets allowance of 5 to 10% per cent, depending on sector; and finally
    - An additional 5% tax-free allowance for companies participating in phase 1 of the carbon budgeting system.

- The combined effect of all of the above tax-free thresholds will be capped at 95%, depending on the emissions activity in question.
- Due to the complexity of emissions measurement in the waste and land use sectors, 100% thresholds have been set i.e. these sectors are excluded from payment of the carbon tax in phase 1.
- The tax base comprises emissions from fossil fuel combustion, emissions from industrial processes and product use, as well as fugitive emissions.
- The greenhouse gases covered include carbon dioxide, methane, nitrous oxide, perfluorocarbons and sulphur hexafluoride.
- The carbon tax on liquid fuels (petrol and diesel) will be imposed at source, as an addition to the current fuel taxes.
- For taxation on stationary emissions, reporting thresholds will be determined by source category as stipulated in the National Environmental Air Quality Act. Only entities with a thermal capacity of around 10MW will be subject to the tax in the first phase. This threshold is in line with the recent DEA Greenhouse Gas (GHG) emissions reporting regulation requirements and the proposed Department of Energy (DoE) energy management plan reporting.
- The carbon tax will be administered by the South African Revenue Service (SARS).

Dr Lotter mentioned that in principle BUSA is not against a carbon tax, but had various concerns around the current draft which should be addressed prior to promulgation. In addition to their concerns about needing better clarity on future phases of the tax, there immediate concerns are:

Firstly, there needs to be better alignment between the Department of Environmental Affairs (DEA) and SARS in the calculation of an organisation's tax liability. For example, some of the calculations in the Bill differ greatly from the DEA reporting guidelines, thus producing an inconsistent emissions figure that will be taxed.

Secondly, there needs to be greater clarity regarding how allowances and carbon offsets will be dealt with, for example the allowance on trade exposure and who would be subject to it?

Thirdly, ensuring the systems link between the Carbon Tax Bill (SARS) and the DEA GHG reporting regulations which will be used to gather information on GHG emissions. The reporting entity to SARS has to be the same registered entity in the GHG reporting system, in order for this alignment to be achieved.

Lastly, alignment is needed between the implementation of the carbon tax and the intended use of a mandatory carbon budgeting system in future. For example, under the current plans there will be an overlap in one year where a company is penalised under both systems. Various proposals on the best means to align the carbon tax and carbon budgets have been tabled, with government expected to make a decision in this regard in due course.

What is clear, is that the carbon tax, along with other additional compliance regulations (for example pollution prevention plans, mandatory GHG reporting) will increase the reporting burden as well as taxation costs on a company. Therefore, it is important to be pro-active by:

- Ensuring that data gathering processes are robust;

- Setting an internal carbon price for decision making and informing the business case on investments;
- Setting a science based target in order to set long term plans to be more efficient whilst growing;
- Taking environmental considerations into account in the strategy of the business, and not seeing it as a mere reporting function; and
- Understanding the carbon tax, the strategic need for carbon pricing and the design and short term impacts of the tax, and actively engage with BUSA through your industry associations.

For more information please contact **Steve Nicholls**.