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State of carbon tax

South Africa's carbon tax regime is beginning to take shape, with several sets of legislation being finalised or published for public comment in the past few months. In this article, we provide our analysis on the various changes and new information that has been made available.

The Taxation Laws Amendment Act (TLAA) which was gazetted on 15 January 2020, and made several technical changes to the Carbon Tax Act (Act 15 of 2019) (CTA). The two most noteworthy changes are those to the tax base, as well as to the allowance mechanisms.

Tax base

The most noteworthy change in the TLAA is to the carbon tax base which is defined in sections 4 (1) and 4 (2) of the CTA. Originally the tax base was defined as the sum of greenhouse gas emissions as determined by a Department of Environmental Affairs (DEA) (now Department of Environment, Forestry and Fisheries [DEFF]) approved reporting methodology.

The original definition would therefore allow DEFF results to be used by the South Africa Revenue Service (SARS) in verifying carbon tax submissions. This was possible as annual emissions reported to DEFF under the National Greenhouse Gas Emissions Reporting regulations (NGERs) in March, would match those reported to SARS in July.

However, it was understood from changes incorporated in the TLAA, as well as stakeholder sessions attended with National Treasury, that section 4 (1) would only be applicable where a taxpayer has an approved Tier 3 reporting methodology, and in all other cases section 4 (2) would apply.

There are certain specific cases where the fuel energy content values provided for use with section 4 (2) of the CTA and those used for reporting to DEFF are different. The impact of this misalignment is that emissions reported to DEFF, and those reported to SARS may not be the same.

Allowances

Originally process emissions received a 70% allowance, and due to a technical error in the drafting, fugitive emissions received only a 10% allowance. With the amendments contained in the TLAA, a 60% basic allowance now applies to all greenhouse gas (GHG) emissions sources. Further to this, process and fugitive emissions sources will receive an additional 10% allowance.

Section 12L

Section 12L has been amended so that the incentive can be claimed for years of assessment ending before 1 January 2023. This prolongs the period for which taxpayers will be able to obtain an incentive for measured and verified energy savings. To date, this incentive has rewarded energy efficient companies with a total of more than R2-billion in tax deductions, although the application process remains stringent.

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Carbon offset regulations
These regulations were gazetted as final on 20 November 2019. There have been several technical changes to the regulations, but no major changes to the process and scope of how the offset regime will work.

Many of the major concerns raised by stakeholders, at the last session hosted by National Treasury in March 2019, have not been addressed. Specifically, we still believe that the regulations are unnecessarily wider in scope than they need to be, dealing with both the generation of offsets and the use of offsets in the South African carbon tax regime, where it is only the latter that should be pertinent under these regulations.

Further, we note that COP25 failed to produce a rulebook and replacement for the Cleaner Development Mechanism (CDM), which may come to an end December 2020. The development of local offset methodologies seems to still be a process in its infancy, with only a framework currently being considered. This means that offset producers will likely have limited options in the short to medium term to generate offsets effectively.

Draft benchmark and trade exposure regulations
Draft regulations regarding the Z-factor benchmark as well as the trade exposure allowance were published for public comment on 29 November 2019.

The benchmark allowance regulations are relatively straightforward, however one important point to note is the requirement for a measured and verified emissions intensity to be used. Currently, a relatively stringent measurement and verification process by a third party South African National Accreditation System (SANAS) accredited entity is required to claim the section 12L energy efficiency incentive. The use of the terminology in the context of carbon tax may indicate National Treasury would require a similar process to claim the benchmark allowance, although no explanation for this term is provided in the draft regulation, and it may still be changed.

The trade exposure regulations are complicated by the possibility of a single taxpayer operating in multiple sectors. To accommodate this, the regulations provide a formula for determining a weighted average trade exposure. The regulations also make provision for a company specific trade exposure calculation, which is a function based on the monetary value of a taxpayers' exports and imports compared to the total sales values of the taxpayer. This would allow a company that is uniquely trade exposed, in a sector which is not, to obtain the allowance. However, there are a number of technical challenges in these regulations which may delay its finalisation.

SARS rules
The SARS rules providing for carbon tax (licensing and payment) were finalised and gazetted on 23 December 2019. The licensing period has opened from 2 January 2020, and the first carbon tax payments are due between 1 and 30 July 2020. The return forms have however not been finalised.

The most noteworthy change to the revised SARS rules is that they provide for a consolidated licensing approach. Rather than having to license each individual facility that performs a GHG emitting activity, a carbon taxpayer will apply for a consolidated license for all its activities over which it has operational control. This should simplify the licensing process for entities that have a large number of small emissions sources to consider.

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