The (un)certainty of taxes: Is the 1 January 2019 implementation date for carbon tax possible?

By Justine Sweet, issued by LexisNexis

19 Apr 2018

One thing is certain in this context: anyone having to sign off on the Carbon Tax Bill has an unenviable job. Though everyone making submissions at the Carbon Tax Draft Bill public hearings held in mid-March appreciates the need for responsible climate change action, many argue that a carbon tax effective from 1 January 2019 and as currently framed, is achievable, but not necessarily the best mechanism.[1]

In February, the then Minister of Finance, Malusi Gigabi, announced a 1 January 2019 implementation date for the carbon tax. Although it was previously indicated that National Treasury would announce the implementation date “taking into account the state of the economy”, arguments were raised during the public hearings that the implementation date announcement was premature. It was also argued that the “timing should be reviewed”, that carbon tax in the “context of the current developmental state of the South Africa would pose a significant challenge” and that it is “not necessary to meet international commitments under the current national circumstances”.

On 15 December 2017, National Treasury published the Second Draft Carbon Tax Bill, the first having been published for comment in November 2015. Comments were due to be submitted by 9 March 2018 with the aim of finalising by mid-2018. However, at the Public Hearings, it was indicated that there would likely be a further round of hearings and a workshop, particularly “to ensure more balanced hearings” and a better understanding of the proposed tax, with stakeholders being urged to engage between themselves and with National Treasury outside the parliamentary processes. Given this context, a finalisation date of mid-2018 may not be feasible.

Reducing emissions

According to the media statement released together with the Draft Bill in December last year, the “carbon tax bill (is intended to) enable South Africa to meet its nationally determined contribution (NDC) commitments in terms of the 2015 Paris Agreement (on climate change), and to reduce (its) greenhouse gas emissions in line with the National Climate Change Response Policy and National Development Plan”.

The media statement further states since the Paris Agreement comes into effect in 2020, “(South Africa’s) efforts to reduce its greenhouse gas emissions and meet (its) commitments cannot be further delayed.”

At a joint meeting of parliament’s finance committees and its environmental affairs committee held in February, the Department of Environmental Affairs (“DEA”) said that the tax would incentivise large emitters to reduce their greenhouse gas emissions (“GHG”) and National Treasury indicated its view that the tax will reduce emissions on a business as usual basis by between 13 and 14.5% by 2025 and 33% by 2035.

However, at the public hearings on 14 March, Business Unity South Africa said that the Bill was not needed to meet the NDC before 2025 as emissions are already below the national trajectory and it recommended that the “implementation date … not be announced until the integration of the tax into the mitigation system has been achieved”. It went further to say that “should the implementation still be considered, further engagement on a number of challenging issues was still outstanding”.

The Bill, in its current form, will see carbon dioxide equivalent emissions determined on the basis of fossil fuel inputs and reported in accordance with the DEA’s National Greenhouse Gas Emission Reporting Regulations. According to the Explanatory Memorandum published together with the Bill by National Treasury, liability will be calculated as the “tax base (total quantity of GHG emissions from combustion, fugitive and industrial processes proportionately reduced by the tax-free allowances) multiplied by the rate of the carbon tax." The overall calculation methodology has been requested to be simplified.

Tax incentives and revenue recycling

The Bill, in its current form, provides for the phased introduction of carbon tax. The first phase, which will apply for four to five years after implementation, will only apply to entities with a total installed capacity that is equal to or above the indicated threshold as indicated in the National GHG Reporting Regulations (mostly a total installed thermal capacity of around 10MW). The proposed tax is R120 per ton of carbon dioxide equivalent for emissions above the tax-free thresholds.

The fossil component of blended fuels or biomass as well as energy recovery from waste is also required to be reported to the DEA (and are therefore taxable). For non-stationery and/or mobile emissions, the carbon tax will be included in the fuel tax regime. However, it was submitted during the public hearings that emissions from petrol and diesel should be treated consistently with all other emissions.

Transitional tax-free allowances are also included in the Bill. These include a basic tax-free allowance of 60 percent; additional tax-free 10 percent allowances for process as well as fugitive emissions; a variable (with maximum 10 percent) tax-free allowance for trade-exposed sectors; a maximum tax-free allowance of five percent for above average performance; a five percent tax-free allowance for companies with a Carbon Budget; and a carbon offset allowance of either five or 10 percent. Promethium Carbon recommended the use of uncapped carbon offsets since it argued that South Africa could achieve the same impact without a cap. Others suggested that the provision for carbon offsets should be more flexible. Concerns were raised that the trade exposure protection is not sufficient to address vulnerable sectors and the need to ensure a level playing field for South African manufacturers was stressed.

Evidently, by combining tax incentives and revenue recycling measures, the tax is planned to be "revenue neutral" in the first phase. The Legal Resources Centre (LRC) said it was "cautiously in accordance with the Bill" but noted a "plethora of issues to be addressed before Parliament is ready to allow the Bill to be enacted". The LRC requested clarification on compliance matters as well as greater consideration of guaranteed revenue recycling, particularly as a means to address the impact on the cost of food and other goods to protect poor communities.

Substantive concerns

Other substantive comments from industry stakeholders included concerns regarding the need for greater consideration of South Africa being an "inherently energy intensive economy with limited access to lower carbon energy alternatives", the unintended consequences and possible irreversible consequences for the economy, the potential to undermine sector contributions to employment and what mechanism should be used to address loss making companies.

Uncertainties in the context of performance allowances, sequestration calculations and the carbon offset regulations must also still be addressed. Alignment remains a key concern. It was argued that climate change action requires alignment with energy and industrial policy. Eskom, which indicated that it is not opposed to the tax, said its primary concerns were alignment with the Department of Environmental Affairs' greenhouse gas management processes and the electricity price impact. Though the Department of Environmental Affairs indicated that there is "in principle agreement" that there will be alignment between the carbon tax and carbon budgets, no further clarity on how this alignment will be achieved has been forthcoming.

Although the World Wildlife Fund regards the tax as a "critical tool in South Africa's climate change toolbox", it argued for the Bill's "appropriate amendment" but "rapid promulgation". It said that "an inadequate tax runs the risk of blunting this tool and an easy and just transition to an all-inclusive economy". The University of Cape Town's Energy Resource Centre recommended a simpler carbon tax regime which incorporates an adjustment mechanism to ensure that the purpose of emission reductions is met. It also submitted that "combining a low tax rate, multiple allowance and deduction from income tax would result in net payments that are negligible". It went on to say that "to operationalise the polluter pays principle, the effective tax rate must be of a non-trivial amount" since ... at the super-low rates that the current draft implies, no change in behavior could be expected". Others argued that as the tax is across all emissions, rather than incentivise mitigation, it is a significant financial burden.

In stressing its support for a transition to a lower carbon economy, Business Unity South Africa emphasized the importance of evaluating the impact before implementing the fiscal instrument and recommended harmonisation across government departments to enable sound mitigation actions.

Reading the calls for a delay in commencement together with the extent of the more substantive concerns which demonstrate the multiple competing considerations and far reaching consequences, it is difficult to contemplate the Bill being finalised in time for a 1 January 2019 implementation date.

Climate change is at least one of the most - if not the most - complex challenges facing humankind. It requires global and interdisciplinary collaboration and commitment. Regulatory development nearly always faces competing considerations requiring compromise and negotiation. However, developing regulatory tools which balance South Africa's fragile economy and the fragile earth and humankind is without doubt, the most complex and difficult challenge facing our law makers. Although there is still much dissent in the debate around carbon tax, one thing is certain ... the need for a South African just response to climate change sooner rather than later.

Lexis® Assure will keep you up to date on the Bill's promulgation. In addition, LexisNexis has secured a team of experts including Mansoor Parker (ENS Africa, Tax Executive), Olivia Rumble and Andrew Gilder (Directors, Climate Legal) to produce a Carbon Tax focused work which will provide background, in depth analysis and guidance on practicalities and implementation.

[1] *Meeting summary of Carbon Tax Draft Bill: public hearings held on 14 March 2018 available at https://pmg.org.za/page/Carbon%20Tax%20Draft%20Bill:%20public%20hearing.*

ABOUT THE AUTHOR

Justine Sweet is an admitted attorney with nearly 15 years' experience in environmental law. She is a contributing author to LexisNexis content solutions. The regulatory environment within the context of climate change can be a challenging one to navigate. Lexis Assure is there to assist. Part of Lexis Nexis South Africa's portfolio of legal research and digital products, Lexis Assure provides daily email alerts, analysis and compliance calendars which assist the user in keeping track of regulatory changes relevant to their business. This online solution allows users immediate access to new developments in legislation, follows risk ratings and provides information on the penalties for non-compliance, laying out all the necessary information as and when it is required. It also integrates with LexisNexis Practical Guidance to deliver a robust collection of case law commentaries, precedents and checklists. With a professional team of experts and its comprehensive database of subject matter, Lexis Assure takes the pressure off seeking and interpreting information and helps ensure 100 percent compliance. For more information, visit [[http://www.lexisnexis.co.za/lexisassure/]].