

13 December 2024

To: The National Treasury
240 Madiba Street
Pretoria
Gauteng

By Email: CarbonTax@treasury.gov.za

Re: Response to the Carbon Tax Discussion Paper: Phase Two of the Carbon Tax

Dear Colleagues,

Please see below comments and feedback on the "Carbon Tax Discussion Paper: Phase Two of the Carbon Tax" published by the National Treasury. These comments have been prepared by the SAIT Environmental Tax Technical workgroup.

Please note that the comprehensive commentary outlined below is based on specific client factual circumstances, and those clients have requested that we seek assurance from you that this information will not be made generally accessible.

Notwithstanding the above, we appreciate the opportunity to contribute to this important discussion.

1. General Comments

Overall, we support some of the proposals and have concerns for others. At a high level a summary of the support and concerns are summarised below:

Support

- We are supportive of the proposal which aims to maintain revenue neutrality pertaining to the price of electricity.
- We are supportive of the proposal to shift towards incentive-based allowances. It is our proposal for National Treasury to consider introducing a new allowance, namely an "Investment Allowance" which will provide a tax credit for investment into decarbonisation projects.
- We are supportive of the retention of the basic allowance for process and fugitive emissions for hard-to-abate sectors.

Concerns

- The discussion paper does not mention the 9th National GHG Inventory Report, which shows that South Africa's greenhouse gas emissions are currently decreasing and that the country is within its Nationally Determined Contribution target¹ so we argue that other policy interventions from government are having an impact.
- Although the proposal to increase the carbon offset allowance is supported. The concern is around the timing of the increase and whether the increase will have any

¹ DFFE, Ninth National GHG Inventory Report for the Republic of South Africa (2 May 2024, Government Gazette No 4772)

real net benefit to business considering the cost of offsets is a small discount to the carbon tax rate. The increase should include a more gradual increase of the carbon offset allowance.

- The ability to claim the performance benchmark allowance should not be linked to approval of the mitigation action plan, considering limitations for mitigation projects for hard-to-abate sectors.
- The trade exposure allowance on fuel combustion emissions should not be removed as industries are trade exposed as a whole, not only on process or fugitive emissions.
- Based on an assessment of companies in various industry sectors², the overall net impact of these changes result in an increase of **244%**³ from 2025 to 2026 (and this has considered that companies can claim the performance benchmark allowance). The average increase of the carbon tax from 2023 to 2026 is more than **350%**.
- This increase is substantial, and it is not aligned to the usual rate of tax increases. The headline carbon tax rate increase is also significantly above inflation, so this gives a strong price signal to business. There is an argument that this increase is sufficient.
- The substantial rise in the carbon tax will hinder the availability of capital needed for investment in decarbonisation projects, unless other financial support is made available.
- Given the significant potential impact of the proposed penalty on the exceedance of the carbon budgets, it is requested that the proposed amendment on the penalty is published in the 2025 Taxation Law Amendment Bill as well as the publication of the Mandatory Carbon Budget and Mitigation Action Plan Regulations.

2. Specific Feedback on Proposals

2.1 Basic Tax-Free Allowance

- **Reduction of Allowance:** It is proposed to reduce of the basic tax-free allowance by 10 percentage points in 2026 and 2.5 percentage points annually from 2027 to 2030.
- **Impact on Industry:** Given the significant increase in the nominal carbon tax rate, as well as the proposed decreases in the other allowances, a 10% reduction in 2026 will have a significant impact on industry. The nominal carbon tax rate increase from 2025 to 2026 is 31%, which is already a significant increase. Compounded with the removal of other allowances such as the trade exposure allowance and carbon budget allowance, this has a significant impact. As it will be described in more detail further on, there is a cost associated in claiming the carbon offset allowance. For this reason, in modelling the impact of carbon tax, the carbon offset allowance cannot be considered.

Based on the data available for roughly 22 different companies in various industry sectors, the overall net impact of these changes result in an increase of their carbon tax liability of **244%** from 2025 to 2026 (and this has considered that companies can claim the performance benchmark allowance). The average increase of the carbon tax from 2023 to 2026 is more than **350%**.

² This included 22 different companies from various industry sectors (Mining, Iron and Steel, Ferroalloys, Chemicals, Cement, Commercial etc)

³ Includes the basic allowance, trade exposure allowance (process/fugitive) and the performance benchmark allowance. It excludes the carbon offset allowance due to the high costs associated with carbon credits.

Given the steep increase in 2026, it is recommended that the basic allowance be phased out more gradually or even delayed by another 5 years to 2031. It is proposed that the basic allowance be phased out by 2.5% per year from an agreed-on start date

2.2 Hard to Abate Sectors

- **Process and Fugitive Emissions Allowance:** It is proposed to retain the 10 percent allowance for hard-to-abate sectors until 2030.

This proposal is supported. Many process and fugitive emissions are either hard-to-abate and technology has not yet been developed to decarbonise these emissions or it has not been proven commercially viable. A five-year timeframe for the implementation of these type of decarbonisation pathways is not practical and many technology replacements will require a phased in approach.

We suggest that this allowance could be increased to give hard to abate sectors further relief.

2.3 Performance Benchmark Tax-Free Allowance

- **Increase in Allowance:** It is proposed to increase in the performance tax-free allowance for combustion emissions from 5 to 10 percent.

It is concerning to link the qualification of the performance benchmark allowance to the approval and implementation of the Mitigation Action Plans⁴. This seems to penalise early adopters of decarbonisation performing below the benchmark if they are not able implement additional mitigation projects in hard-to-abate sectors (especially in implementing projects that are able to reduce **direct emissions**). It will therefore become very difficult for hard-to-abate sectors to claim the performance benchmark allowance, irrespective of their ability to perform below the benchmark which they should be rewarded for. Significant technological advancements would be required to further direct emissions. If there are limitations to implement mitigation projects on direct emissions then based on this assessment of the proposal, hard to abate sectors would not be able to qualify for the performance benchmark allowance.

To reference benchmarks to EU ETS which have received significant government support in their transition is not fair as South African has not received the same level government support.

In addition to these challenges, the DFFE typically takes approximately eight to nine months to review and approve the annual progress reports submitted for National Pollution Prevention Plans. These reports are submitted annually by 31 March, but approvals are only received by the end of November. As a result, the approvals are unlikely to be available in time for the Carbon Tax filing deadline in July each year.

2.4 Carbon Offsets

⁴ There are currently no draft regulations available for Mandatory Carbon Budgets or Mitigation Action Plans under the Climate Change Act (2023).

- **Increase in Offset Allowance:** It is proposed to increase the carbon offset allowance by 15 percentage points for both combustion and process emissions.

Although the proposal to increase the carbon offset allowance is supported. The concern is around the timing of the increase and the real effective benefit to business.

It is important to note that the current carbon credit purchase price results in a 10 to 20% discount on carbon tax payments. This effectively means business still pays an effective carbon tax of 80 to 90% of current carbon tax rate.

Currently there is a shortfall of carbon credits in the market. There would need to be an estimated excess of 15 million carbon credits available per year from 2026 onwards for companies to benefit from the increased offset allowance (excluding Eskom). This is roughly the same amount of the carbon credits that have been retired in the Carbon Offset Administration System over the past four years and these credits have included credits from projects which were registered before carbon tax was implemented.

Although there are several developments underway to develop a local carbon offset framework and a local carbon offset standard, this has not been finalised, and even once the regulatory framework is in place, the market still needs time to develop. It is not expected to be ready by 1 January 2026 and it is not expected to have addressed the significant shortfall of credits in the market by this date.

Furthermore, the use of carbon offsets is not recognised under the EU CBAM and the UK CBAM. Using the carbon offset allowance effectively decreases the explicit price of carbon paid when calculating the financial implications of importing goods into countries with a CBAM in place.

This decreases the recognised price of carbon paid in South Africa for purposes of avoiding double taxation at the EU and UK border. This should be considered when decreasing allowances and increasing the carbon offset allowance as a trade-off.

It is therefore recommended that the increase in the carbon offset allowance be reviewed to ensure business can really benefit from this allowance.

2.5 Trade Exposure Allowance

- **Increase in the Trade Intensity Index:** It is proposed to increase the trade intensity index to 50% and to remove the trade exposure allowance from fuel combustion emissions.

The change from 30 to 50% trade intensity index as threshold will impact marginal trade-exposed sectors more than the already highly trade exposed sectors. High exposed trade industries still receive the same allowance, whereas other smaller sectors will now have a lower allowance. The formula for determining the exposure for multiple sectors does not account for the proportion of exposure for an individual company. As an example, a company with a trade exposure of 69% on sector 1, and 0% for sector 2, could have a net trade exposure of 0% due to the overall exposure of sector 1 and 2.

In any manufacturing plant, the equipment for these different sections is all interlinked. Therefore, one could conclude that outputs that are trade exposed include all the processes of combustion, process and fugitives. Therefore, reducing the trade exposure allowance in the combustion portion disadvantages these companies. If an industry is trade exposed, the industry is trade exposed as a whole and not only on its process emissions.

It is understood that the trade exposure allowance was removed from fuel combustion to allow for an increase in the performance benchmark. However, given the challenges described above in achieving the performance benchmark, especially for hard-to-abate sectors, the trade exposure allowance for fuel combustion should not be removed.

A wide range of industries in South Africa are trade exposed in that they are significantly affected by international trade dynamics and global economic conditions. South Africa in turn is a trade-dependent economy. Given the increased competition that South African industries face, the trade intensity index of 30% should remain in place and the trade exposure allowance is not removed from fuel combustion emissions.

2.6 Electricity Sector Reforms

- **Electricity Price Neutrality:**

In terms of the impact on the price of electricity, it was stated that the impact on the price of electricity ranges from 4.7 c/kWh – 11.7 c/kWh. This includes the basic allowance, and the carbon offset allowance. Carbon offsets come at a cost and the cost of offsets will therefore have an impact.

The impact of carbon tax on the price of electricity should be modelled without inclusion of the carbon offset allowance (given the shortage of supply of carbon credits in the market), and the cost associated with acquiring carbon offsets. The impact of carbon tax on the price of electricity should also be modelled taking into consideration the deduction of the renewable energy premium and the actual impact of the pass-through provided.

Based on the information available in the public domain and performing a calculation of the Carbon tax for Eskom, taking the renewable energy premium into consideration, it is expected that a carbon tax pass through will be required in 2028, and the impact is expected to be significant thereafter. Clarity on the impact on the price of electricity is therefore requested from National Treasury.

- **Performance Allowance for Electricity Generators:**

A performance benchmark for the electricity generation sector is supported.

3. Revenue Recycling Measures

- **Support for Strategic Priorities:** The proposed revenue recycling measures, including support for the expansion of the electricity grid, reskilling programs, and public transport infrastructure is supported.

- **Green Hydrogen Incentives:** Tax incentives for green hydrogen production and other strategic low-carbon investments is supported. However, a 100% allowance is wholly inadequate to assist the green hydrogen economy, a 150% allowance is proposed.
- **Section 12L EES to end and be absorbed into the carbon offset scheme:** It is requested that Section 12L EES be extended to 2030 as there is too much complexity in the carbon offset scheme. Section 12L is a very successful incentive because it is well administered and simple. Moving into the carbon offset scheme will significantly hinder the ability to benefit from the incentive. In addition, clarity will be required regarding the eligibility of the project types (within the carbon tax boundary or not, and clarity will need to be provided regarding the additionality criteria – which presents a significant hurdle to qualify).
- If the Section 12L Incentive does become absorbed into the carbon offset scheme – it is proposed that the same eligibility criteria to remain in place, because moving 12L into the carbon offset may likely exclude projects that would normally be allowed. This is because projects in 12L are project that are within the carbon tax net.
- For the Section 12L incentive, we would rather propose a simpler solution than trying to get carbon credits for 12L projects (trying to get carbon credits will take very long and is very hard to do). We would propose to change it so that the 12L becomes a tax-free allowance under the carbon tax.
- Noting that in some cases, companies are in a tax loss position, and they don't "benefit" from it. A potential proposal in this case could be to change design so that the Section 12L is changed into a tax-free allowance which could also become a tradeable allowance – therefore incentivising companies to go ahead with the energy efficiency project and result in emission reductions and still qualifying for an incentive for it by trading it to others that have a tax implication.
- **Section 12BA:** it is proposed to extend Section 12BA to 2030.
- **We propose National Treasury to consider a new carbon tax allowance "Investment allowance":**

It is proposed to introduce a new allowance which is linked to a Capital Investment (like the Section 12I tax incentive) in decarbonisation projects. But rather than be an Income tax deduction we propose it is a carbon tax allowance.

The design should include receiving a tax credit under carbon tax linked to the capital cost of investment into decarbonisation projects (i.e. for every rand in capital investment this should be equivalent to the tax deduction to your carbon tax liability i.e. R1 million capital investment is equivalent to R1 million carbon tax deduction). The eligibility criteria should include that the project results in real greenhouse gas emission reductions and this can be verified using eligible assessors (the DFFE have a list of eligible assessors that can verify GHG emissions, and this can be done in accordance with ISO 14064 part 2).

Conclusion

In conclusion, we appreciate the comprehensive approach taken in the discussion paper to address the complexities of carbon pricing and its impact on various sectors. We look forward to engaging with Treasury in a constructive manner in the stakeholder workshops that will take place in January 2025.

Sincerely,
SAIT Environmental Tax Technical Workgroup

End.