DRAFT CARBON TAX BILL 2017

DRAFT RESPONSE DOCUMENT

STANDING COMMITTEE ON FINANCE

7th June 2018

Presenters: National Treasury, Department of Environmental Affairs and South African Revenue Service

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Presenters

- National Treasury
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  - Christopher Axelson
  - Yanga Mputa
  - Sharlin Hemraj
  - Memory Machingambi
- Cecil Morden
- SARS
  - Franz Tomasek
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- Department of Environmental Affairs
  - Tlou Ramaru
  - Deborah Ramalope
  - Maesela Kekana
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Background

- The **initial draft Carbon Tax bill was published for public comment in November 2015** following Cabinet approval in Oct 2015.
- **Cabinet adopted the second Draft Carbon Tax Bill and approved the submission of the draft bill to Parliament on 16 August 2017** noting the carbon tax as an integral part of the system for implementing government policy on climate change.
- **National Treasury published the second Draft Carbon Tax Bill in** December 2017 for public comment, introduction in Parliament, and convening of public hearings by Parliament in early 2018.
  - The closing date for public comments on the Bill was 9 March 2018. **Fifty nine (59) written comments** was submitted to the Treasury
- **Briefing of the SCoF and PC Environment** by the National Treasury and Department of Environmental Affairs in February 2018 followed by **public hearings** which was held on 13 March 2018.
- The **policies reflected in the 2017 Draft Carbon Tax Bill is a refinement of the 2013 Carbon Tax Policy Paper and the initial 2015 Draft Carbon Tax Bill**. It should thus be noted that many of the public comments on these earlier documents were incorporated into the 2017 version of the draft bill.

Background

- Draft Carbon Tax Bill was published before the 2018 Budget, and did not state date of implementation
- Budget 2018 announcement that implementation will be from 1 Jan 2019

- No bill means no implementation date
  - but having the bill enables the Minister to announce a date (which still needs to be approved by Parliament)

- Given the process for the bill is likely to be completed towards end of the year, Government will have to consider moving the date of implementation a bit later, but not too late given our NDC commitments and period of implementation for Phase 1 before Phase 2 kicks

- Minister can update the date of implementation when introducing the bill or at next MTBPS or Budget.

Carbon Tax Policy Process - Timeline

Environmental Fiscal Reform Policy Paper
(2006)
LTMS
(2007)

Carbon Tax Discussion Paper
(80 comments)
(Dec 2010)
NCCR- WP
(2011)

Carbon Tax Policy Paper
(115 comments)
(May 2013)

Carbon Offsets Paper
(77 comments)
(April 2014)

Draft Carbon Tax Bill
(91 comments)
& Draft Regulations on Carbon Offset (65 comments)
(2015-16)

Revised Carbon Tax Bill published
Dec 2017
Submission to Parliament
2018

Carbon Tax Policy Changes – 2013 to 2017

1. **Electricity pricing and electricity levy:** Carbon tax (taken with electricity levy) will be revenue neutral in the first phase and have no impact on the price of electricity.
   - **credit for electricity generation levy** and for **renewable energy premium**
   - In addition business already benefits from **energy efficiency savings tax incentive – rate for allowance was increased from 45 to 95 cents/kWh in 2015**
2. **Tax rates and thresholds** for phase 1 and 2 of the carbon tax: To provide policy certainty, **Section 5 of the bill was amended to** include the headline, marginal tax rate of R120/t$CO_{2e;}$ and specifies the annual increase to the nominal carbon tax rate by a max of inflation plus 2 per cent.
3. **Alignment of the carbon tax policy with the carbon budgeting system of the DEA**:
   – Phase 1: Introduction of the 5% carbon budget allowance in 2014
   – Phase 2: DEA and NT working on **alignment and integration of the carbon tax and carbon budget** instruments for phase 2, and no double penalty.
   - **An integrated review process to assess both instruments will be conducted after three years of implementation of the carbon tax**
4. **Carbon tax modelling study – modelling of the current design undertaken through the World Bank in 2016** and the socio-economic impact of the carbon tax shows a significant impact in reducing the country's emissions, without a significant impact on growth (negative 0.05-0.15%).

Carbon Tax Policy Changes – 2013 to 2017 (2)

5. **Trade exposure allowance** adjusted from a company to a sector-based trade exposure allowance. Further adjusted the qualifying threshold for the maximum allowance from 50 to 30 per cent trade intensity
6. **Carbon tax pass through** allowed for regulated sectors – liquid fuels
7. **Process and fugitive emissions** – provision of the 10 per cent additional tax free allowance
8. **Offset allowance** – scope of offsets expanded eg. Inclusion of certain renewable projects
9. **Sequestration** – deduction for sequestered emissions eg from forestry plantations
10. **Application of thresholds** – Aligning reporting and classification of greenhouse gas emissions for tax purposes with mandatory emissions reporting to the Department of Environmental Affairs. Only emissions above the thresholds for reporting are subject to the tax (2014)

Main comments on 2017 Draft Carbon Tax Bill

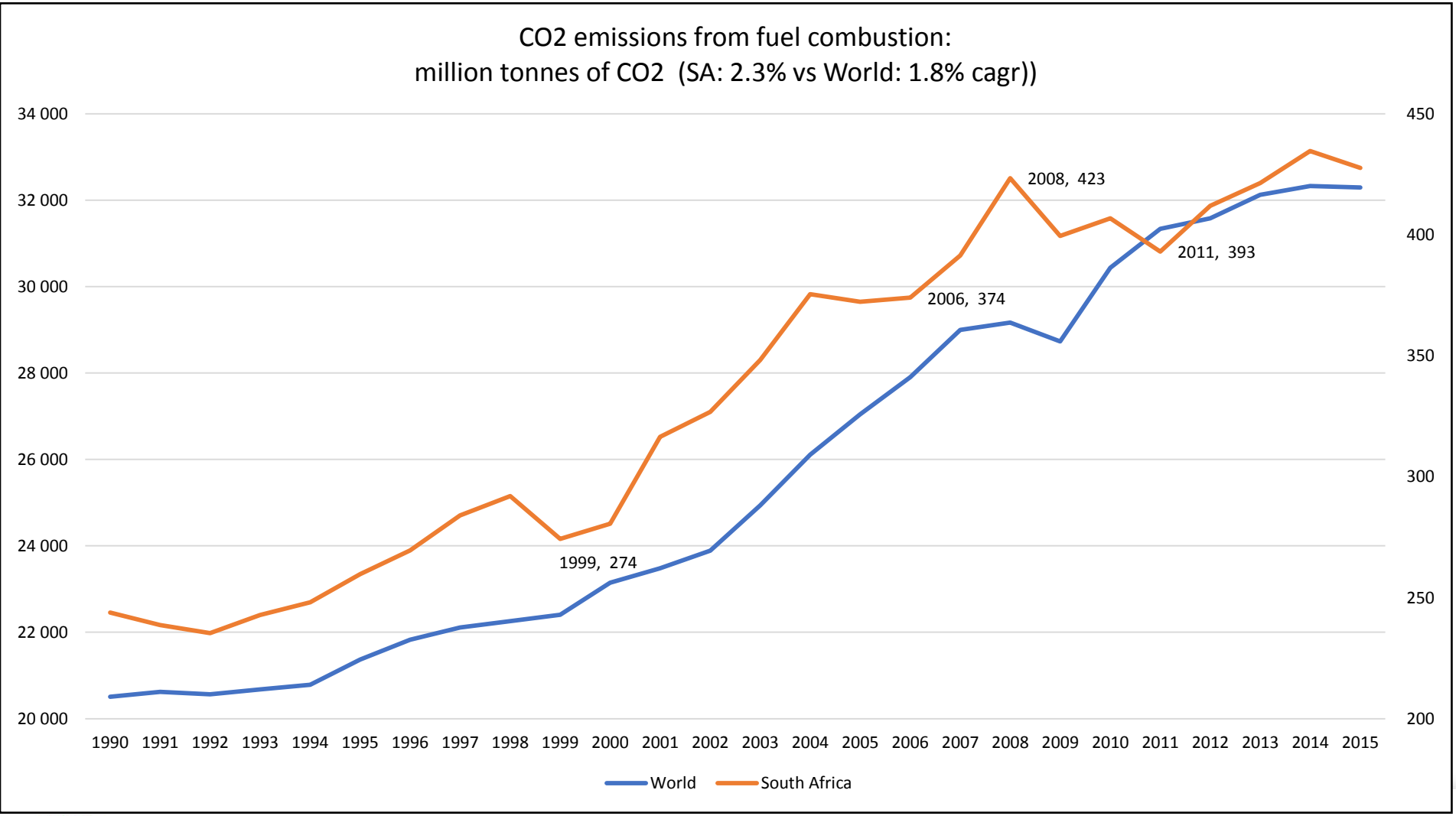
1. Carbon tax rate is too low
2. Carbon tax modelling and socioeconomic impact
3. Long term certainty and timing of the introduction of the tax
4. Policy alignment with the carbon budgets
5. Energy efficiency savings tax incentive extension
6. Taxation of domestic aviation fuels – alignment with global mechanism
7. Use of the Customs and Excise Act and Payment of the tax

South Africa's NDC Commitment, GHG emissions trajectory and the carbon tax

COMMENTS:

- Some **stakeholders noted the carbon tax as a critical tool in South Africa's climate change toolbox** which is necessary to meet both international obligations and address local constitutional and developmental requirements**. The draft Carbon Tax Bill was commended as a landmark piece of legislation** to guide future efforts and the carbon tax was viewed as a critical tool for pricing GHG emissions as a key element of the national mitigation strategy.
- In addition, it is argued that a **lower level of economic growth does not obviate the need for a carbon tax to incentivise further reductions in overall carbon dioxide emissions**. It is also recognised that the PPD trajectory is a range, as indicated by the 398 to 614 MT CO_2e in the national policy and NDC and South Africa's emissions are significantly above the lower PPD trajectory range.
- **Other stakeholders suggest that greenhouse Gas (GHG) emissions are below the national benchmark trajectory and unlikely to increase above this level before 2025, a carbon tax is not required** for South Africa to achieve its Nationally Determined Contribution (NDC) before 2025.

IEA CO_2 Emissions from Fuel Combustion, OECD/IEA, Paris, 2017.



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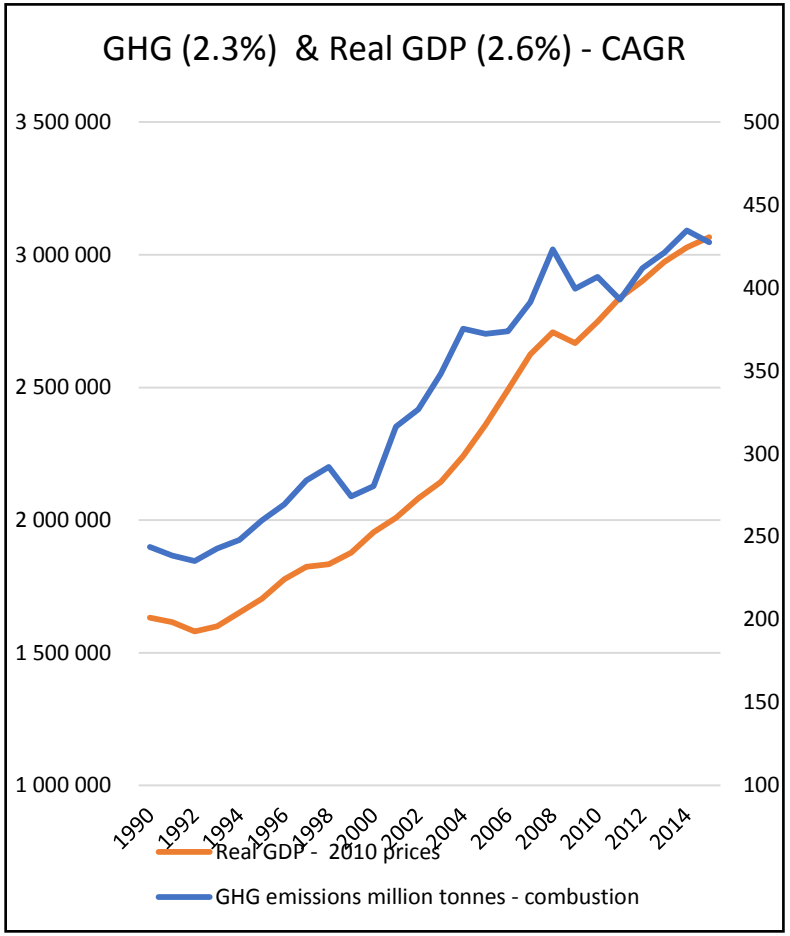
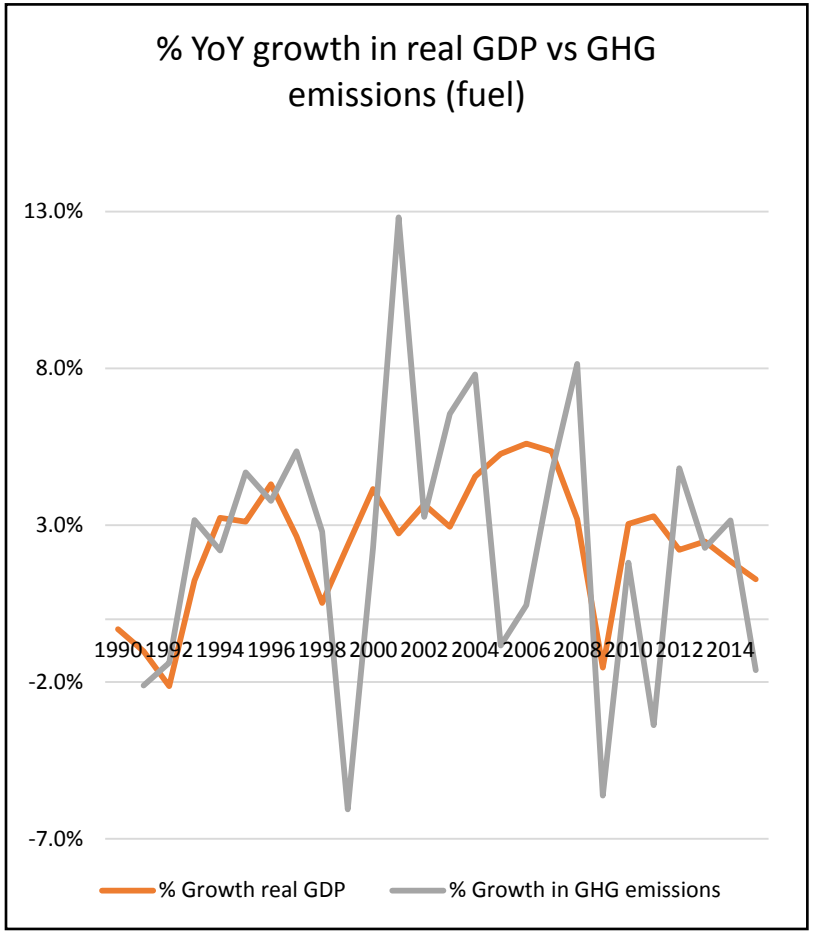
South Africa – Real GDP vs GHG emissions (fuel combustion)





IEA: % of World CO_2 Emissions - Fuel Combustion

		1990	2000	2001	2002	2008	2009	2015
1	People's Rep. of China	10,1%	13,3%	13,8%	14,6%	22,7%	24,5%	28,0%
2	United States	23,4%	24,4%	23,9%	23,2%	18,9%	17,8%	15,5%
3	India	2,6%	3,8%	3,9%	3,9%	4,6%	5,3%	6,4%
4	Russian Federation	10,5%	6,4%	6,3%	6,1%	5,3%	5,0%	4,5%
5	Japan	5,1%	4,9%	4,8%	4,9%	3,8%	3,7%	3,5%
6	Germany	4,6%	3,5%	3,5%	3,4%	2,7%	2,5%	2,3%
7	Korea	1,1%	1,9%	1,9%	1,8%	1,7%	1,7%	1,8%
8	Islamic Rep. of Iran	0,8%	1,3%	1,4%	1,4%	1,7%	1,8%	1,7%
9	Canada	2,0%	2,2%	2,2%	2,2%	1,9%	1,8%	1,7%
10	Saudi Arabia	0,7%	1,0%	1,0%	1,1%	1,2%	1,3%	1,6%
11	Brazil	0,9%	1,3%	1,3%	1,2%	1,2%	1,1%	1,4%
12	Mexico	1,3%	1,6%	1,5%	1,5%	1,5%	1,5%	1,4%
13	Indonesia	0,7%	1,1%	1,2%	1,2%	1,2%	1,3%	1,4%
14	South Africa	1,2%	1,2%	1,3%	1,4%	1,5%	1,4%	1,3%
15	United Kingdom	2,7%	2,2%	2,3%	2,2%	1,7%	1,6%	1,2%
16	Australia	1,3%	1,4%	1,5%	1,5%	1,3%	1,4%	1,2%
17	Italy	1,9%	1,8%	1,8%	1,8%	1,5%	1,3%	1,0%
18	Turkey	0,6%	0,9%	0,8%	0,8%	0,9%	0,9%	1,0%
19	France	1,7%	1,6%	1,6%	1,5%	1,2%	1,2%	0,9%
20	Poland	1,7%	1,3%	1,2%	1,2%	1,0%	1,0%	0,9%

GHG emission trends SA vs World

- The annual **GHG emissions** for South Africa (fuel combustion only) has been **increasing in absolute terms between 1990 and 2015.**

- World annual GHG emissions have similarly increased during this period.

- However, in relative terms **South Africa's annual GHG emission have increased at a faster rate than the world average** (2.3% per year vs the world average of 1.8% per year).

- The annual GHG emissions are sensitive to the business cycle, this is clearly observed during the world recession in 2008/09 and the slower economic growth experienced by South Africa between 2008 and 2011, also in 1998/99 and again in 2015

- South Africa's most recent slowdown in the absolute levels of GHG emissions is expected to reverse as soon as the economic growth recovers. It would therefore be irresponsible to say we must do nothing and wait until growth recovers before we take action. Given the inaction to date – and relative high growth in our GHG emissions the need for pre-emptive action is now more urgent than ever before.

Carbon pricing in numbers (State & Trends of Carbon Pricing 2018 – World Bank & Ecofys)

INTERNATIONAL CARBON PRICING INITIATIVES

88 NDCS
plan or consider using carbon pricing and/or market mechanisms

56%
of global GHG emissions are covered by these NDCs

REGIONAL, NATIONAL AND SUBNATIONAL CARBON PRICING INITIATIVES

45 NATIONAL
25 SUBNATIONAL
jurisdictions with carbon pricing initiatives

51 CARBON PRICING INITIATIVES
implemented or scheduled for implementation

WOULD COVER ANNUAL GLOBAL GHG EMISSIONS OF
11 $GtCO_2e$ = 20%

PRICES IN THE IMPLEMENTED INITIATIVES
US$1-139/$tCO_2e$
46% of the emissions covered are prices <US$10/$tCO_2e$

Carbon pricing revenues raised by governments in 2017 were
US$33 billion
Higher compared to US$22 billion in 2016

Annual value of carbon pricing initiatives in 2018 is
US$82 billion
Higher than the value of US$52 billion for 2017

INTERNAL CARBON PRICING INITIATIVES

OVER 1,300 COMPANIES
are using or planning to use internal carbon pricing in 2018-2019

84%
of these companies are located in jurisdictions with (scheduled) mandatory carbon pricing initiatives

INTERNAL CORPORATE CARBON PRICES ARE IN THE RANGE OF
US$0.01-909/$tCO_2e$

Carbon Tax Rate – is too low

COMMENT:

- **To operationalize the "polluter pays principle suggested that the effective tax rate will have to increase in real terms** for a significantly longer period in order to make a material difference to SA GHG emissions.
- The proposed tax rate of R120 per ton of CO_2e (about US$10) is well below the carbon tax rates of other countries, and the High-Level Commission on Carbon Prices which suggested that price should be at least US$40–80/tCO2 by 2020 and US$50–100/$tCO_2$ by 2030.
- **Suggested that the initial price should at a minimum be pegged at the same level as originally proposed in 2012 (approximately R150 in 2018 rand)**, and should be increased to US$40 before 2030

RESPONSE:

- **Noted and partially accepted**. **Section 5 of the bill specified the** headline, marginal tax rate of R120/$tCO_{2e;}$ and the annual increase to the nominal carbon tax rate by up to a maximum of the rate of inflation plus 2 per cent. The annual adjustment of the rate as per the current proposal in the bill of CPI plus 2 per cent for the first phase will therefore be maintained.

Carbon tax rate (2)

COMMENT:

- **Some stakeholders are of the view that for the first phase of the carbon tax, the tax rate should be fixed at R120/ton CO_2e** with a motivation for subsequent adjustments to the rate while others suggested that changes to the tax rate should be limited to inflationary adjustments.

RESPONSE:

- **Not accepted.** The phased approach to the introduction of the carbon tax at an initial low rate with significant tax-free allowances seeks to provide industry with the time and flexibility to make the necessary structural adjustments required to transition to a low carbon economy.

Carbon Tax Modelling and Socioeconomic Impacts

COMMENT:

- Some stakeholders suggested that the underlying assumptions used in the carbon tax modelling study could overstate the benefit of implementing a carbon tax in South Africa and suggested that these assumptions are assessed and that further modelling and analysis of diverse economic scenarios and implications including the prevailing and forecasted economic condition is considered.

RESPONSE:

- Several carbon tax modelling studies have been undertaken to date, by the National Treasury (Economic Policy Unit), local academics and international institutions such as the World Bank.
- The broad findings from these Computable General Equilibrium models show that a carbon tax will make a significant contribution to the reduction of GHG emissions and that the economic impact of the carbon tax will depend on how the revenues are used, that is revenue recycling.

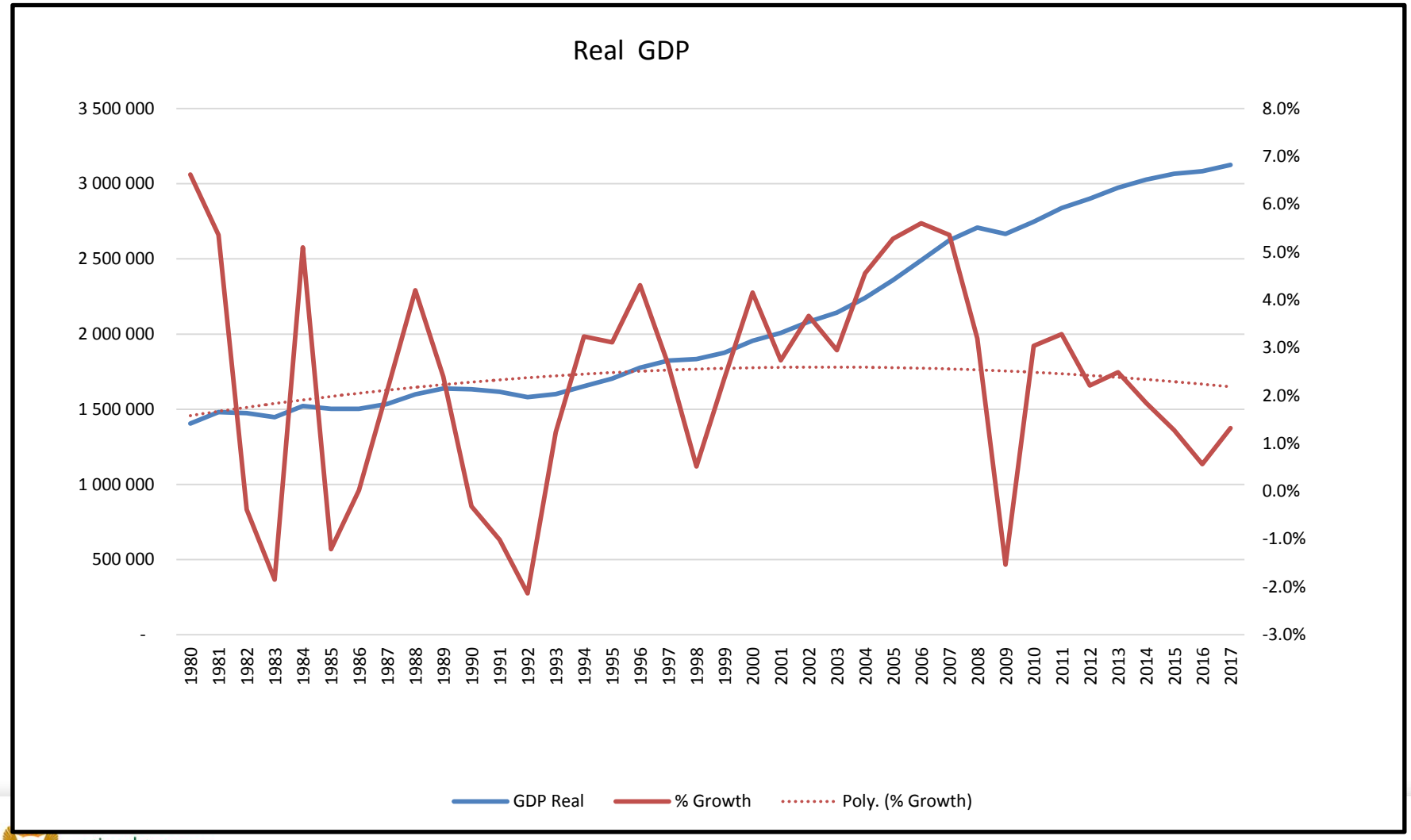
The modelling considers a range of scenarios

- We identify one combination as the 'focus' scenario, but all sensitivities are explored
- **Tax scenarios**
  - T1: tax rate increasing by 10 percent per annum over the period 2016–21, and thereafter by the assumed inflation rate (5.5 percent); tax-free thresholds are held constant for the duration of the modeling period 2016–35. Ag and waste exempt
  - **T2: as T1, but the tax-free allowances are gradually removed at a rate of 10 percentage points per annum from 2021. Ag and waste exempt**
  - T3: as T1, except for the agricultural sector where the exemption is removed at a rate of 10 percentage points per annum from 2026
  - T4: T2+T3, ie tax-free allowances are gradually removed at a rate of 10 percentage points per annum, starting in 2021, for all industries except agriculture, for which phasing out begins in 2026

Revenue recycling scenarios (all revenues recycled)

- **R1: Recycling of tax revenues is applied through an output-based rebate on all production across all sectors**
- R2: tax revenue is recycled through a decrease in the VAT rate on all the goods that make up household spending
- R3: a combination of R1 and R2 (split 50:50)
- R4: subsidy on the production of renewable electricity generators (for modeling purposes, directed towards solar PV)
- R5: The tax revenue is used to decrease the VAT rate on agricultural goods, food, transport services, and beverages and tobacco

Real GDP: 1980 to 2017: Average between 2.0 and 2.5%



Carbon Tax Modelling and Socioeconomic Impacts (2)

RESPONSE (cont)

1. The main results are presented against a baseline scenario of annual GDP growth of 3.5 percent from 2016 onwards, constant inflation at 5.5 percent, and population growth of 1 percent per year.
2. In the alternative baseline the economy grows at a more modest rate of 2.4 percent per year between 2018 and 2035. Under this alternative baseline, economic growth slows to 0.9 percent in 2016 before increasing to 2.4 percent for the period between 2018 and 2035.
3. The proposed carbon tax would lead to an estimated decrease in emissions of 13 to 14.5 percent by 2025 and 26–33 percent by 2035 compared with business-as-usual. This suggests that the carbon tax would make an important contribution towards reaching the 42 percent reduction by 2025 target, but would need to be complemented by additional policies if this target is to be met. Alternatively, a higher carbon tax rate than currently envisaged could be adopted.
4. **If these tax-free thresholds were to persist between 2021 and 2035 then the emission reductions delivered by the carbon tax would fall significantly: from 33 percent below the business- as-usual baseline to just 26 percent.**
5. Under the alternative baseline, emissions levels that are 40–50 per-cent lower than the baseline in 2035. Although the deviations are greater under the revised baseline, the relative impact of the different scenarios is very similar

Long-term policy certainty and timing of introduction of the tax

COMMENTS:

- There was support for the policy certainty provided on the carbon tax, both in the Second Draft Carbon Tax and in the budget speech in February 2018. Some stakeholders argue that **the lack of policy certainty on the carbon tax regime beyond 2022 will impact business decisions on future investments and technology** choices.
- Some are of the view that **the proposed implementation date of the carbon tax does not provide sufficient time to address the administrative challenges** for taxpayers, SARS and the DEA. Other stakeholders however suggest that given the significant delay in implementing the carbon tax and the urgency of the issue, the cost of not taking action to reduce GHG emissions will be detrimental. **It is recommended that government should implement the carbon tax with immediate effect.**

RESPONSE:

- **Noted.** To provide the required policy certainty, the Minister of Finance announced the implementation of the carbon tax as from 1 January 2019 in Budget 2018.
- **Noted.** A review of the impact of the tax after at least three years implementation will be conducted. Any adjustments to the carbon tax instrument beyond the first phase will depend on the economic circumstances and emissions mitigation efficiency achieved.
  - The review will take into account the progress made to reduce GHG emissions, in line with NDC Commitments.
  - Future changes to rates and tax free thresholds in the Carbon Tax will only follow after the review, and be subject to the same transparent and consultative processes for all tax legislation, after any appropriate Budget announcements by the Minister of Finance.

Alignment with the Carbon Budgets

COMMENT:

- Some stakeholders were of the view that there will be duplicate and contradictory policy requirements for business should the first phase of the carbon tax overlap with the imposition of mandatory carbon budgets by the DEA.
  - Support for a basic tax-free allowance equal to the carbon budget (with no further allowances for trade exposure or performance) which is applied such that the company would only have a carbon tax liability on those emissions in excess of the budget.
- Some stakeholders suggested that the carbon tax, as a carbon pricing instrument, can be implemented in parallel without the need to specify the means of alignment of the two mechanisms or systems i.e. both the carbon tax and the carbon budgets are implemented independently.

RESPONSE

- **Accepted.** The mandatory carbon budgets regime will be introduced in a way that is fully-aligned with the carbon tax, and designed to ensure no double penalty. **In-principle view that the carbon tax could apply to emissions above the carbon budget approved by DEA.** An integrated review process to assess both instruments will be done after three years of implementation of the carbon tax, and will inform any significant changes in the tax rate and the implementation of the carbon budgets

Revenue Recycling – Energy efficiency savings tax incentive Section 12L

COMMENT:

- Some stakeholders suggested that the S12L Energy Efficiency Savings tax incentive should be incorporated into the Bill as an offset against the carbon tax and be extended beyond 2020 to ensure that there is long term certainty on revenue recycling. Clarity was requested on the total value of the incentive and if all the revenues collected from the carbon tax would be recycled into the energy efficiency savings tax incentive (S12L).

RESPONSE:

- **Partially accepted**. National Treasury will consider extending the duration of the EES incentive and aligning the incentive with the first phase of the carbon tax. A review of the Energy Efficiency Savings Tax incentive will also be undertaken in collaboration with the Department of Energy and SANEDI. Initial analysis suggests that the monetary value or subsidy for energy efficiency investments is about R3 billion. **This measure was specifically introduced as one of the options for potential revenue recycling**, even though the carbon tax had not yet been introduced.

Energy Efficiency Savings Tax Incentive: Applications per sector to date

List of approved projects / certificates (up to May 2018):

Project	Activity	kWh Saved	Technology
1	Manufacturing	15 940 704	Whole Plant Optimisation
2	Manufacturing	5 094 504 657	Operational Energy Efficiency
3	Manufacturing	3 573 590	Energy Efficiency Project
4	Mining	35 224 669	Operational Energy Efficiency
5	Mining	83 909 700	Energy Efficiency Project
6	Manufacturing	122 567	Lighting Retrofit
7	Manufacturing	59 254 015	Energy Efficiency Project
8	Manufacturing	9 638 183	Whole Plant Optimisation
9	Commercial Building	175 302	Lighting and HVAC
10	Commercial Building	100 675	Lighting and HVAC
11	Commercial Building	124 254	Lighting and HVAC
12	Commercial Building	(99 475)	Lighting and HVAC
13	Commercial Building	681 766	Lighting and HVAC
14	Commercial Building	128 680	Lighting and HVAC
15	Commercial Building	(123 531)	Lighting and HVAC
16	Manufacturing	61 406 520	Whole Plant Optimisation
17	Manufacturing	93 757 774	Whole Plant Optimisation
18	Manufacturing	215 977 808	Whole Plant Optimisation
19	Manufacturing	96 876 426	Whole Plant Optimisation
20	Manufacturing	159 422 461	Whole Plant Optimisation
21	Mining	2 017 987	Energy Efficiency Project
22	Mining	1 457 024	Energy Efficiency Project
23	Manufacturing	363 217	Lighting Retrofit
	Total kWh saved	**5 934 434 973**	
	Estimated cost to fiscus (Rand)	**2 672 908 688**	

Liquid fuels – Domestic Aviation

COMMENT:

- The aviation sector supports a carbon pricing instrument applicable to domestic flights which is aligned with the Carbon offsetting and Reduction Scheme for International Aviation (CORSIA) mechanism.
  - Suggested that an effective interface between the carbon tax and CORSIA could be created by increasing tax-free allowances for performance from 5 to 10 per cent and carbon offsets allowance from 5 to 10 per cent (preferably this could be increased to 100 per cent) and removing the trade-exposure allowance for the sector.

RESPONSE:

- **Accepted.** Following the stakeholder consultations on the initial 2015 draft bill, the National Treasury engaged the sector and agreed to consider the options to ensure that the carbon tax regime for domestic aviation should be aligned with the CORSIA approach and principles. In November 2017, the National Treasury developed a proposal for the taxation of domestic aviation and consulted with the Departments of Transport, Environmental Affairs and the Civil Aviation Authority.
  - The **overall tax free-threshold for domestic aviation will be increased from 90 per cent to 95 per cent by adjusting the carbon offset and performance allowances** for the sector. This will be in line with the CORSIA basket of measures.

Administration – Use of the Customs and Excise Act

COMMENT:

- Stakeholders are of the view that the Customs and Excise Act is not the appropriate legislation under which to administer the carbon tax as it is designed to deal with goods that can be easily identified, requires licensing of warehouses although GHG emissions are reported at a company level. A separate Carbon Tax Administration Act is suggested or the tax to be administered in terms of the Tax Administration Act similar to other taxes such as the Mineral Royalties.

RESPONSE:

- **Not accepted.** The base of the carbon tax is the CO_{2e} of greenhouse gas emissions. These gases are classified under the World Customs Organisation Harmonised System and are tradable commodities. This means the base of the carbon tax is goods as defined in the Customs and Excise Act, 1964. The administration of the carbon tax as an environmental levy under the Customs and Excise Act, 1964, is the most suitable solution, considering that these taxable greenhouse gas emissions are environmentally harmful goods of which the externality costs should be internalised.
- **Noted. SARS is willing to consider innovative licensing solutions specific to the carbon tax for the licensing of facilities** including:
  - could be tied to the activity that gives rise to the taxable emissions. In instances where several connected facilities are involved in a singular activity that is subject to the carbon tax, one consolidated license could be considered; or
  - where a company holds several licenses over multiple licensed facilities, consideration could be given to combining those licenses under the company as a singular licensee

Payment of the tax

COMMENT:

- The 6 monthly payments of the carbon tax are deemed onerous in the case of greenhouse gas reporting – suggested that the payment period is aligned with the DEA Reporting period of one calendar year and is paid annually after the final submission of GHG emissions data to DEA.

RESPONSE:

- **Noted.** Further consideration will be given to the request for one annual carbon tax payment. Under such a proposal, the tax period and accounting period would run from 1 January to 31 December. The account for that year, together with the payment of the carbon tax liability, would then be due by 30 June of the following year as DEA would only have verified the declared emissions by May of that following year.

Legal Aspects and Update on Regulations

- **Definitions**
  - Carbon budget
  - Fugitive emissions
  - Greenhouse gas emission
- **Allowances -** Acceptance of “must”
- **Waste emission**
  - Anomaly in the bill of taxation of waste sector emissions will be addressed.
- **Regulations**
  - Regulations for carbon offsets and trade exposure will be published for comments and finalised by September 2018.
  - Benchmarks developed by industry will be reviewed under the PMR project commencing in the third quarter and regulations drafted and published thereafter.

THANK YOU