Dear Davis Tax Committee

COMMENTARY ON THE CARBON TAX POLICY PAPER (“POLICY PAPER”) AND CARBON OFFSETS PAPER (“THE PAPER”)

1. The South African Institute of Chartered Accountants (SAICA) appreciates the opportunity to present our collective feedback to the Davis Tax Committee (DTC) on the Carbon Tax Policy Paper.

2. We have set out below comments pertinent to policy extrapolated from the comments of our Carbon Tax Committee (a Sub-Committee of SAICA’s National Tax Committee) in respect of the Carbon Tax Policy Paper (Annexure A) and the Carbon Offset Paper (Annexure B) as submitted to National Treasury.

POLICY EXECUTIVE SUMMARY

Comprehensive research

3. In principle we support government and its policies to address the environmental impact of manmade waste, whether air, water or land based.

4. However, where actual emissions are not being restricted directly, but indirectly through incentivised behavioural change in the form of an additional tax charge or through incentives, the impact should be properly researched as it could have material unanticipated collateral negative effects on the people of South Africa and its economy.

5. In our view, limited research has been done and the proposed timelines do not allow for any comprehensive research to be conducted.

6. For example:
   - There will be no time to allow for the required detailed analysis to be made to guide the future of the proposed carbon tax pricing policy.
• The carbon credits available from eligible South African CDM projects will be reduced to more or less 8.4 million if properly estimated; more than halving the estimated supply in the Paper.

• There is no costing model or estimation as to the future cost to the economy of the current proposals as well as the cost to administer both the tax collection or the measurables it is based on.

• The policy paper shows favour towards the design of the tax being structured as a “fuel input tax”. This statement is supported from the policy paper that emissions, and the associated carbon tax, will be calculated as a function of the fossil fuel consumption, using approved emission factors for each source of fuel. The inclusion of process and fugitive emissions as categories under which additional tax-free thresholds could be obtained however confuses the issue with a directly measured emissions tax, as these emissions would be calculated using different emission factors – depending on the process being utilised and its unique efficiencies.

• There seems to be no impact assessment of unintended consequences or to prevent abuse or unfair competition which will erode the integrity and transparency of the system so implemented. Therefore ensuring that the tax is fair and does not disproportional affect the vulnerable does not seem to have been researched. As discussed below, the constitutionality of the proposed system has been subjected to scrutiny in another country. It was held to be unconstitutional on two grounds: namely that the exemptions contained did not address the primary declared purpose of the levy namely, to combat carbon emissions and hence “global warming”; and that the exemptions would cause the levy to fall disproportionately on gasoline and heating oils and not on other carbon emissions, thereby breaching the principle that taxation should be evenly and fairly borne.

7. It is submitted that the current proposals should be properly researched in line with the concerns raised through the public participation process. Only once government is in a position to make an informed decision should a policy decision be made and the proposed action plan on how to implement can then follow. Decisions should not be taken based on political expediency or global ambitions of other parties, especially where the latter is driven by non-comparable economies or those who have historically disproportionately contributed to the current global problem.

Exit strategy

8. As a new tax with great impact, it would be detrimental to unconditionally bind South Africa to a system which we have not set clear protection mechanisms and criteria when we will exit from it voluntarily. It is noted that the tax is to be phased in gradually, but the policy document seems silent on the triggers and thresholds for a phasing out, should policy goals be achieved or otherwise, such as economic downturn. The document further lacks clarity regarding the formulation of an exit strategy should any unforeseen material detrimental effects arise after its implementation.
9. It should not be forgotten that efficiency and reduction will come at a cost and South Africa should be clear on what that cost is and what the amount of the cost is that we are willing to make. Once that cost is exceeded, we should be in a position to exit, both in practice and financially to ensure the least disruption to the market at the least cost.

10. It is submitted that too little policy thinking has gone into this aspect of implementing the carbon tax and that it should be fleshed out

**Early adoption**

11. It would seem from a global perspective that adoption of the carbon tax within the time lines indicated would be ideologically leading the way, but early adopters will inevitably suffer financially the most, especially against developing countries such as India and China who have substantially stronger economic growth at the current moment.

12. Firstly the base line of early adopters would be lower meaning that they suffer the punitive effects more than later adopters (i.e. in 2020) who will have substantially higher base lines. For example South Africa’s emissions base line is currently most probably lower than 2008 because of the economic downturn and problems at Eskom. Setting a threshold in the current economic conditions would therefore result in South Africa penalising its economy twice because it is in a slump.

13. Secondly the early adoption will mean that economic growth within the current stifled global economy will be further strangled while our peers and competitors use the opportunity to build their economies to a stronger threshold before implementing the carbon emissions reductions.

14. In our view the early adopters should be limited to developed countries that have mature economies and more stable emissions base lines.

**Proper reinvestment of revenues from the carbon tax**

15. Revenues from carbon taxes could be directed in different ways. Revenues can either be (1) directed specifically to carbon mitigation programs, (2) directed to individuals through corporate or social cost easing measures, or (3) used to supplement government budgets. The systems in Finland and Sweden make no provision for the returning of the revenues from the tax to those affected by it. This, it is considered, is a less than desirable outcome and one that should most certainly be avoided in a South African context.

16. Although the temptation exists for the South African authorities to expand their tax base in light of its cumulative deficit and use the revenues collected from the carbon tax to reduce the deficit, it is proposed that such a result would be disastrous in a South African context.

17. We have already seen in South Africa how ineffectual the electricity levy has been in achieving its desired aims because of the fact that it is included in the general revenue fund. Furthermore the inclusion of the fuel levy in the general revenue fund has led to disastrous decline in investment in road maintenance and development.
18. It is submitted that any tax imposed to create a behavioural change through a carrot and stick approach should be properly purpose ring-fenced to prevent abuse or inaction derailing the identified policy objectives.

**Cost burden and administration concerns**

19. The administrative cost has not been determined as it is still unclear how the administration would work. However from the information provided it does not bode well for South Africa.

20. For example the mandatory reporting of Scope 2 emissions in excess of 100,000 tons generated from the electricity sector in effect shifts the point of responsibility, as well as the administrative and cost burden from the actual point of fuel input to the consumer. This means that it even targets the most vulnerable in society.

21. Furthermore the current proposal may even constitute economic double taxation where the electricity levy if to be retained as indicated. In this regard, consumers will be paying two taxes in respect of electricity, whether or not they are intended to be a tax on the same component of electricity, remains to be seen, but the inevitable consequence of a dual increase in the price of electricity, remains a reality.

22. The ability and proficiency of government departments to work together to measure the basis of the tax and collect the tax has from past experience shown to be inefficient and sometimes dysfunctional. This comes at a great administrative burden and cost to business and end consumers.

23. For example, in order to execute the operational requirements around the carbon offset mechanism, it has been our experience that these administrating authorities (i.e. South African National Energy Development Institute (SANEDI) functioning within section 12I and section 12L of the Income Tax Act, and the Department of Science and Technology (DST) functioning within section 11D of the Income Tax Act) are ill-educated with regards to their role within the legislative environment, and do not understand the significance their actions (and lack of actions) have on the requirements of the legislation in which they function. These administrative authorities further also tend to be under staffed, and accordingly, lack the necessary technical resources and competency to deal with the complex nature of these applications. Together with SARS’ sometimes overzealous nature to police both entry into the system and its implementation, it just substantially increases risk on business and the cost of the system as a whole.

**Effective incentives**

24. Having proper incentives such as the carbon offset scheme is imperative to ensure that financial benefit does flow to those who change their behavioural usage in line with government policy.

25. In our view standards as basis for the incentive may not be the ideal mechanism. As mentioned in section 5.2 and 5.5 of the paper, the cost, administrative burden, complexity and long turnaround times associated with these standards could prove to be a major hindrance to the success of the carbon offset mechanism in the market and could potentially result in the ultimate failure of the market – as has been the case in Europe with the European Union Emissions Trading Scheme (EU ETS).
26. It is submitted that the effectiveness of thresholds and viability thereof should be properly considered before implementation with a transparent consultative process.

27. Should the conclusion remain that standards are to be the basis of the incentive, South Africa should be cautious trying to reinvent the wheel. Making use of the current standards in existence (i.e. CDM, VCS and Gold Standard) to issue CERs will go a great distance in ensuring credibility and confidence in the market with regards to the carbon offset mechanism. It will further also ensure that a degree of local familiarity and existing competence in these standards could be utilised to implement and expedite the process of developing CERs in South Africa.

28. This approach minimise the cost on implementation and increases reward.

Conclusion

29. Government’s intention to address a looming global crisis is laudable and fully supported.

30. Imposing a tax to bring about behavioural changes has had little effect in South Africa or elsewhere. For example sin taxes on alcohol and cigarettes are imposed at punitive levels and yet are ineffective in changing behaviour. The detrimental effect of the continued use is still evident within our communities with little or no immediate signs of subsiding.

31. The manner in which it is addressed is critical to ensure that we do not exchange one detriment for another of equal weighting. The conclusion should be of overall benefit, even if only in the long run. This can in our view only be achieved through comprehensive research and informed public consultation in a transparent manner. Implementing something such as a carbon tax without proper consideration will affect everyone, be it business, consumers or government and may result in the envisaged benefits not being achieved in any event.

Should you require any clarification of the matters raised above we would welcome any discussion on the submissions made.

Yours sincerely

Izak Swart
Chairman: SAICA Carbon tax committee

Pieter Faber
Project Director: Tax
CARBON TAX POLICY PAPER

A. Implementation

1. This section addresses the following aspects of the design features pertaining to the implementation of the proposed carbon tax: (1) phased approach, (2) tax-free threshold and additional relief for certain sectors, (3) offsets, (4) exemptions and (5) tax rate.

   Phased Approach

2. In recognition of the tax as a policy instrument and not a revenue generator, clarity needs to be provided whether the pricing will be sensitive to policy outcomes. And if so, how that will be linked to the desired outcome for South African Greenhouse Gas (GHG) emissions to peak, plateau and decline, as we have pledged internationally and confirmed in national policy. In light of the anticipated policy outcomes, the need further also exists for greater clarity on the price path of the policy in the longer-term.

3. It is noted that the tax is to be phased in gradually, but the policy document seems silent on the triggers and thresholds for a phasing out, should policy goals be achieved or otherwise. The document further lacks clarity regarding the formulation of an exit strategy?

4. It should further also be considered that total emissions in South Africa may also be reduced by factors not causally related to the tax, such as shrinkage of the economy or the wide-spread successful introduction of clean energy sources, and would require that the tax would accordingly need to be reconsidered to take these triggers into account in achieving the goals set out in the policy.

5. It is proposed that South Africa compliment a system of carbon tax with intensive studies which will investigate the emissions levels (as at the date of enactment of the tax) against emissions target levels for the initial phases of the tax and into the short to medium term future. The reason for such studies is to ensure that the ultimate goal of reducing carbon emissions is not lost sight of, and that in setting the initial rate, as well as in contemplation of any future rate changes, the effect of the rate on the emissions levels is considered.

6. Fundamentally, it is essential that there is some method of measuring carbon and other GHG emissions so as to ensure that tax is being effective and to note, if necessary, which areas need to be refined so as to achieve the original objectives behind the introduction of the tax.

   Tax-Free Threshold and Additional Relief for Certain Sectors

7. The policy paper shows favour towards the design of the tax being structured as a “fuel input tax”. This statement is supported from the policy paper that emissions, and the associated carbon tax, will be calculated as a function of the fossil fuel consumption, using approved emission factors for each source of fuel. The inclusion
of process and fugitive emissions as categories under which additional tax-free thresholds could be obtained however confuses the issue with a directly measured emissions tax, as these emissions would be calculated using different emission factors – depending on the process being utilised and its unique efficiencies.

8. Although the concept of tax-free thresholds are novel by nature, defining and identifying unambiguous triggers at which these thresholds should be applied, as well as the quantum that should be allocated to a single emitter, seems highly complex, and accordingly questions the effectiveness and fair implementation of such a mechanism.

9. The technical and structural reasons which limit the potential for reduction in emissions and the degree of trade exposure of carbon-intensive sectors in South Africa could potentially allow for highly technical debates, which would undoubtedly open the implementation of the tax free thresholds to interpretation; creating an uneven playing field for industries.

10. The additional benefit that is to be obtained as a result of the tax-free thresholds is heavily reliant on the sector in which a company would be classified. The sector classifications are however erratic within the document and poorly defined, which creates ambiguity. In addition to this, the “Z-Factor” proposed in the document, which allows for additional relief by means of adjusting the basic tax-free threshold 5% up or down (with the maximum total threshold capped at 90%), is heavily reliant on the sector benchmarks against which individual companies would be measured. The proposed preliminary benchmarks are however out-dated, and not consistent or applicable to the South African industry. The document however acknowledges the complexities associated with establishing benchmarks, which could potentially question the readiness of South Africa to introduce and effectively administrate the carbon tax in its proposed format and within the suggested timeframe.

11. The potential for discriminative exemption provisions finding their way into a South African carbon tax system is certainly a reality. The “tax-free” thresholds proposed would therefore need to be carefully constructed so as to ensure the sustainability of entities operating in the designated sectors, while not creating exemptions that can be said to be discriminatory and thus shifting the burden of the carbon tax onto only a specific industry/operating segment of the economy.

Exemptions

12. It is crucial to the effectiveness of the carbon tax system that decisions concerning the granting of exemptions are economically viable and socially acceptable. Failure to do so will facilitate anti-competitive behaviour, prejudice certain industries and erode the integrity and transparency of the system so implemented. As one might learn from the first proposal embodying a French carbon tax, inequitable and potentially abusive exemptions and rebate provisions will be considered to go against the objective of a system of carbon tax and may even result in the proposal being ruled unconstitutional. As discussed, this system was deemed to be unconstitutional on two grounds: namely that the exemptions contained within the provisions for a carbon levy vitiated the primary declared purpose of the levy, to combat carbon emissions and hence “global warming”; and that the exemptions would cause the levy to fall disproportionately on gasoline and heating oils and not on other carbon
emissions, thereby breaching the principle that taxation should be evenly and fairly borne.

13. The current proposed system seems to provide preferential treatment to the electricity sector, as the emissions reductions target in South Africa's integrated energy plan (IEP) is inconsistent with the National emissions targets, targeted by the carbon tax policy. The ability of the electricity sector to fully pass on its carbon tax liability places considerable pressure on the non-electricity sectors to reduce its emissions and could be a reason for the inequitable implementation of the proposed policy instrument.

**Tax rate**

14. Without question, the primary objectives behind implementing a carbon tax are to reduce carbon emissions and motivate all parties to move towards cleaner, greener and renewable sources of energy. But if in addition to this main principle, one considers the socio-welfare implications of the tax as being of critical importance, then the characteristics of the tax will need to account for these factors. As a result there are two main and interdependent considerations that need to be dealt with in setting an initial rate of tax. Firstly, how strong a signal is deemed necessary to ensure that consumers begin to change their behavioural patterns, and secondly what will be done with the revenues so derived. It may seem that the considerations relating to the revenues collected from the tax occur at the other end of the scale in terms of implementing the tax, but in truth they are vital in setting the rate of tax at the correct level.

15. In Australia, the rate proposed expanded on the second consideration and contained two variations depending on the means intended to be achieved by the implementation of the tax. The proposed rate was determined by taking the revenue required to achieve an increase in the income-tax-free threshold to $10,000 or to drop the top marginal tax rate to 30%, estimating the total emissions levels to be subject to the tax, and solving for the applicable rate that would ensure such revenue levels were generated. In a similar manner, but merely by altering the desired welfare consequence of the tax, it was suggested that a $30AUS per tonne CO2e carbon tax could be used to fully offset all the current fuel taxes in existence in Australia. However, it was deemed appropriate (presumably to further lessen the burden brought about by the introduction of the tax) to introduce the tax at an initial rate of $23AUS per tonne CO2e. This point emphasise the need for the initial price of the carbon tax to be set at level that will not cause undue hardship upon introduction of the tax.

16. Adopting a different approach, the officials in British Columbia (BC) sought to introduce their version of a carbon tax at a relatively low rate (C$10) and gradually increasing this initial rate by C$5 per annum reaching a target rate of C$30 in 2012. This method of implementation allowed consumers and businesses firstly to adapt gradually to the idea of a carbon tax and secondly to take higher future energy costs into account when making decisions of a long term nature. Thus in this case the motivation was also to protect those affected by the tax, but the approach taken to set the rate used the rate as the starting point working towards the revenues, and not the revenues so derived to establish the rate.
17. It is submitted that, owing to the relatively high levels of fuel levies in place in South Africa, accounting for approximately 33% of the total fuel price, it would be desirable to adopt an approach such as the one suggested in Australia, where the rate is set at a level that will allow for a full reduction in fuel levies. Alternatively, it may be considered more equitable to phase in the tax gradually per the BC approach and consequentially reduce the fuel levies over time as opposed to entirely upfront. As noted, the effectiveness of the rate decided upon, and the public’s response thereto depend significantly on the interplay between that rate and the manner of relief provided for by the returning of revenues.

B. Revenue Recycling

18. Revenues from carbon taxes could be directed in different ways. Revenues can either be (1) directed specifically to carbon mitigation programs, (2) directed to individuals through corporate or social cost easing measures, or (3) used to supplement government budgets.

19. The systems in Finland and Sweden make no provision for the returning of the revenues from the tax to those affected by it (it is believed however, that the Finnish carbon tax is accompanied by reductions independent cuts in income taxes). This, it is considered, is a less than desirable outcome and one that should most certainly be avoided in a South African context. Although the temptation exists for the South African authorities to expand their tax base in light of its cumulative deficit and use the revenues collected from the carbon tax to reduce the deficit, it is proposed that such a result would be disastrous in a South African context.

20. Firstly, an approach as described would imply that the main motivation behind implementing the tax is to increase government revenues without consideration for the effect of carbon emissions on climate change. Secondly, the welfare implications would be severe and lower income households would suffer at the hands of the tax. The inflationary implications of the tax would drive prices of affected goods higher and no supplementary income would be available to individuals and corporations. And finally, there would be no guarantees that the revenues so derived would be used for infrastructural development of cleaner technology and renewable energy sources.

21. The study conducted by Alton et al. (2012), regarding the economic implications of introducing carbon taxes in South Africa, highlighted that revenue recycling implemented via either a reduction in sales taxes or corporate taxes, or via social transfers will ultimately result in reduced employment levels, a reduction in private and public consumption and investment, as well as a slowdown in economic activity.

22. It is submitted that the single most important characteristic of a carbon tax is the manner in which it provides for mechanisms to create sustainable economic value that will minimise and counteract the impact of an increased financial burden on society and industry created as a result of the tax. This characteristic, as has been shown, has consequential implications for almost every other aspect and component of the tax. It is essential to any South African carbon tax proposal that the tax is entirely revenue neutral.

23. For South Africa, it is proposed that the mechanism to be put in place to render the system of carbon tax as being revenue neutral be one that makes use of so-called
“tax shifting” which aims to reduce the tax burden on a specific and existing component that has an equal scope to that of the proposed carbon tax. Examples of such tax shifts, as proposed in Australia, could result in the revenues from the carbon tax being used to increase the income-tax-free threshold above its current level or to drop the top marginal tax rate; or used to fully offset all current fuel taxes. As noted, owing to the high level of fuel levies in place in South Africa, it may be desirable to reduce such levies through the revenues derived from the carbon tax. Alternatively, and perhaps more equitable, the revenue neutrality of the tax could be achieved through a partial reduction in fuel levies accompanied by a reduction in payroll taxes as well. Thus, people who are not severely influenced by the fuel levies owing to their use of public and alternative means of transport might still benefit by paying less income tax.

24. While a valid argument exists for using the revenues from a carbon tax to develop cleaner technologies and invest in infrastructure that will stimulate the production of renewable sources of energy, it is submitted that such steps may take a significant amount of time to return the benefits to those affected by the tax, worsening the impact of the tax on all, especially the poor. In addition, the South African Government has shown limited interest in the development of such technologies and infrastructure, and thus it is suggested that the mechanism adopted to transfer the benefits of the revenues of the tax back to those paying the tax, be that of a tax shifting arrangement.

25. Therefore, it is proposed that the exact method of revenue recycling, along with the manner in with such a process is to be administered and who is to be responsible for such a process, be clearly defined and stress-tested to ensure the practical workability thereof.

C. The Tax Base

26. As a general rule, the carbon tax should be applied to the purchase or use of fossil fuels within the country of question. This would include transportation fuels, natural gases, and fuels used in industrial processes. The tax base should include fuels used to generate heat for households and industrial processes such as producing cement and drying coal and all road, rail marine, and air transportation occurring within the country.

27. It is submitted that the tax base be made as broad as possible, following the approach adopted in BC and therefore subjecting consumption of all fossil fuels to the tax. Exemptions from the application of the tax should, as per the system in British Columbia (BC) – discussed under section (4) of this chapter, be considered necessary only when required for integration with other climate action policies in the future and for efficient administration of the tax. That is to say that, the only fuel types not included in the tax base, are those that do not qualify as “fossil fuels.” Examples of such fuels types are referred to as biomass fuels or biofuels, firewood, wood waste, ethanol, bio-diesel and bio-heating oil. The motivation behind exemption of the emission of CO2 produced from the combustion of biomass is because the carbon released by combustion was first drawn from the atmosphere by the plants through the process of photosynthesis and have thus, in their own right, already served to reduce the extent of carbon emissions in the atmosphere.
28. Expanding on the point noted by BC concerning the efficient administration of the tax, in New Zealand the proposal allowed for the exemption from the tax of methane and nitrous oxide emitted by the agricultural sector owing to it not yet being feasible and cost effective to tax such emissions. Thus it is essential that the logistical and practical considerations of actually administering a carbon tax are taken into account when determining the scope of the emissions subject to the tax.

29. South Africa would therefore have to identify, by way of preliminary study, those emissions sources that are not cost efficient or indeed practical to administer.

30. South Africa should also focus on internalizing of the cost of combustion and resulting emissions by only taxing the emissions produced from burning fossil fuels within the country. Thus, by following the example of BC, South Africa should exempt certain fuel uses that do not result in emission of GHGs in this country. Such exemptions may apply to inter-jurisdictional commercial marine and international aviation transport services, as well as fuel and fossil fuels that are to be exported.

D. Measurements

31. The policy paper refers to the introduction of mandatory reporting of GHG emissions for entities, companies and installations that emit in excess of 100,000 tons of GHG annually. The mandatory reporting is however not limited to only the scope of the carbon tax, which is Scope 1 emissions, but also requires reporting on Scope 2 emissions. The mandatory reporting of Scope 2 emissions in excess of 100,000 tons generated from the electricity sector in effect shifts the point of responsibility, as well as the administrative and cost burden from the actual point of fuel input to the consumer. This shift in responsibility, along with the current pricing policy in the electricity sector which allows for the full cost to be passed onto the consumer, deteriorates any incentive for the electricity sector (which is the biggest contributor towards GHG emissions in South Africa) to mitigate its carbon tax liability and in effect questions the objectiveness of the policy being proposed.

32. Further to this, the policy paper does not elaborate on how the mandatory reporting of GHG emissions will be controlled, and audited. Therefore, it is suggested that the legislation dealing with the carbon tax sets out exactly how accountability is established in respect of the reporting of GHG emissions which will form the basis of the implementation of the tax. In addition to any verification procedures that may result in additional costs being borne by the remitters, the reality is that certain procedures required to be implemented to give effect to measurements needed, will also introduce additional costs, thus resulting in indirect expenditure linked to the carbon tax.

33. Possible relief will need to be considered in respect of these additional obligations that will be placed on remitters. Such costs are administrative costs as opposed to the actual tax itself, and thus in a different form, introduce a double expenditure burden on the remitters.

E. Administration

34. Virtually all of the carbon tax systems in the world have been implemented as an extension of existing structures as administered by the respective countries revenue and customs authorities where appropriate. Thus in keeping with the example of
those that have gone before, it is envisaged that the South African Revenue Service (SARS) will serve as the administrator of the carbon tax. SARS has a customs division that too could be used to facilitate the application of the tax on fossil fuels imported into the Republic for domestic use or consumption. SARS have however recently proven, with the introduction of the Royalty Tax, that it struggles to deal with the effective introduction and administration of complex new systems, of which the carbon tax would probably be most so. This further questions the wisdom in the time frames (commencement date and the five year introduction phase) as proposed, as there exists a real possibility that these time frames will not allow for the required detailed analysis to be made which will guide the future of the proposed carbon tax pricing policy.

35. Notwithstanding these challenges, the motivation for using the standard rules as applied by the respective revenue authorities in handling other taxes and extending their application to the carbon tax mechanisms, as suggested in the New Zealand proposal, is to ensure that the carbon tax is fully integrated into the existing systems of tax, thereby facilitating an efficient and effective adoption process. A corroborative reason is that certain of the methods envisaged to return revenues to those effected, include tax shifting arrangements and certain ‘green cheques’ which by their very nature will apply to registered taxpayers. Common administration of the carbon tax with other taxes will facilitate the interplay between the levying of the carbon tax and the returns of revenues through the reduction of other taxes, without the need to involve other parties in a cross communication of information that may very well detract from the efficiency and integrity of the process.

36. As alluded to earlier, there may be a need for collaboration with audit firms to ensure that the emissions levels report by taxable entities are certified and that the tax is thus based on actual emissions levels. There may be a valid argument for requiring the entities affected by the tax at the level at which it is implemented to report in their annual financial statements so as to promote the transparency of the tax and ensure that those emitting GHGs are held to account.

37. On the matter of reporting, clarity is required from the policy paper with regards to the frequency of reporting and payment, registration requirements and at which level these actions would be required (i.e. installation, company, taxpayer, etc.). These guidelines will be useful in establishing the additional costs of compliance to the carbon tax.

F. Double Taxation

38. One might well question the steps that government will take in relation to those existing environmental taxes listed and described previously. If a carbon tax is implemented on top of such measures, consumers might bear the brunt of an effective economic double tax.

39. Alternatively, and potentially more fairly, government may consider the taxes currently in effect when setting the initial rate at which to introduce the carbon tax so as to allow them to effectively phase out those other taxes in the face of a single carbon tax. To maintain the other environmental taxes and levies while implementing a carbon tax would require careful drafting of the exemption, rebate and refund provisions of the governing legislation embodying the carbon tax so as to ensure that
the same items are not taxed under various different statutes. As has been seen, extensive exemption provisions can be problematic and even err on the realm of becoming unconstitutional.

40. The policy paper repeatedly refers to the fact that the electricity levy inter alia, will not be abolished upon introduction of the carbon tax. However, it is submitted that the policy paper does not consider the full implication of maintaining the electricity levy, and the natural passing on of the tax that will arise once it is introduced. Put differently, consumers who are already faced with the electricity levy will upon electricity producers being able to pass on the majority of the carbon tax, also be subjected to increase prices brought about by higher, in effect, input costs pertaining to the production of electricity.

41. Therefore, in this regard, consumers will be paying two taxes in respect of electricity, whether or not they are intended to be a tax on the same component of electricity, remains to be seen, but the inevitable consequence of a dual increase in the price of electricity, remains a reality. This needs to be addressed upon introduction of the carbon tax, by for example abolishing all “ancillary economic taxes”, such as the electricity levy, the plastic bag levy and the emission tax on new vehicles purchased.

G. Economic Impact

42. The South African economy has been struggling to recover since the onslaught of the global economic recession in 2009; with 2013 first quarter growth figures of 1.9% only further underlining this fact. Unemployment was last recorded as hovering round the 25% mark, while the decline in the value of the Rand has most likely pushed inflation to above the target range of 3%-6%. The recent industrial strife, particularly in the mining sector, has potentially also scared off foreign investors, desperately needed to fund the large current-account deficit.

43. Given the current economic turmoil which South Africa faces, it seems unwise to introduce an additional burden (administrative and/or financial) on the economy, especially since its impact on the structure of the economy is still largely unknown, apart from the comments of largely limited modelling studies done on the impact of such a tax on the South African economy – all of which does not bode well for the economic growth prospects of the country.

44. In implementing the proposed tax on carbon emissions, significant attention needs to be dedicated towards establishing its impact on the economy.

45. Should the carbon tax be introduced by January 2015, the current proposed tax mechanism will indirectly allow for the electricity to be increased by 4.8c per kWh consumed, increasing by 10% per annum for the first five years. Although the initial rate of introduction will most likely reduce emissions in the more carbon-intensive sectors, the price at which the tax needs to rise in order to achieve the policy outcome of absolute reduction in emissions will limit the economy’s ability to further reduce emissions, eventually also affecting less carbon-intensive sectors, such as services (Alton, 2012).

46. A review of various pieces of literature (Deloitte, 2012) shows that, over the past two decades, the dominant driver of electricity consumption in South Africa has been economic growth and that the impact of price was negligible but that it is expected to
play an increasing role. The study would seem to suggest that the indirectly allowance for a further increase in electricity would put the growth of the economy in limbo, as investors would need to re-consider the cost of doing business in South Africa.

47. The study further suggests that the relatively electricity intensive mining and manufacturing sectors are to suffer the largest declines in output and employment as electricity prices increase, which seems to suggest that the introduction of carbon taxes would create immense pressure on the mining and manufacturing sector. A reduction in employment in the mining and manufacturing sectors could further intensify the industrial strife witnessed in the recent past, and in doing so weaken investor sentiment and placing the economy under further pressure.

48. With regards to the Border Carbon Adjustments (BCAs) mentioned in the policy paper, the mechanism only seems to favour those countries to whom are being exported to. It is highly unlikely that South Africa will be able to implement and enforce these trade measures, due to the country’s net import position and dependence on these imported products. The increased cost of doing business in South Africa, the anticipated decline in competitiveness from the local business sector and the unlikeliness of South Africa to implement retaliatory trade mechanism for carbon-intensive goods leaves the trade posts of the country open for import abuse.

H. Indications of Legislative Process

49. A consideration that South African authorities would need to continue to engage with is whether to enforce the tax on upstream or downstream sources of targeted emissions. It has been noted that arguments exist for the implementation of the tax at either of these stages. As noted in the updated Carbon Tax Policy Paper, it is the intention of National Treasury to levy the tax upstream. Taxing upstream sources is believed to facilitate an administratively efficient method of tax collection, while taxing downstream sources such as electricity and fuel consumption has the effect of providing a more direct signal to consumers. BC imposes and collects the tax at a wholesale level preferring this method as it reduces the cost of the administration of the tax to the government as well as the compliance cost to those collecting the tax on government’s behalf. This method of collection is almost identical to that applied to motor fuel taxes in BC, and as such may be the most desirable path for South Africa to follow owing to our experience with motor fuel levies and taxes.

50. If this approach is found to be undesirable, then it is suggested that the tax be implemented as far upstream as is practical. This would be at the point where possession of the carbon-bearing fuel passes from the “producer” (e.g., coal mine; oil wellhead or tanker; gas wellhead) to the immediate next entity in the supply chain (e.g., coal shipper or utility; oil refiner or importer; natural gas pipeline).

51. A final refinement to the design of the tax base would be to provide the opportunity for partial or total rebate of the tax payments if the paying entity can prove that some or all of the carbon emissions will be prevented from entering Earth’s atmosphere permanently. It is therefore proposed that such elements of the proposed Carbon Tax be explored in more detail and clearly structured such that entities are aware of
what they are required to do so as to avail of such rebates. The motivation for including such rebate considerations is that they have the advantages of:

- Providing for a fair and workable treatment of "partial combustion" which will vary by user and use (for example: unburned coal in ash that is returned to the mine for underground disposal; possibly also cement manufacturing, and plastics manufacture).

- Creating positive incentives to minimize emissions.

- Placing the burden on the fuel producer to demonstrate emissions avoidance thereby reducing the administrative complexities of the system.
ANNEXURE B

CARBON OFFSET PAPER

1. Although we agree in principle on the design features of the carbon-offset scheme, there is a need for more clarity with regards to the criteria for achieving eligibility for the additional 5% to 10% tax-free threshold. There is currently no certainty around the requirements to allow for either a 5% or 10% additional tax-free threshold, and whether a sliding scale will be implemented between the 5% and 10% (i.e. allowing for 6, 7, 8 and 9% reductions also), or whether a binary approach will be utilised (i.e. either 5% or 10%).

2. It is further suggested that the tax-free threshold allowed from carbon-offsets be increased to a maximum of 70% once phase one of the proposed carbon tax has come to an end and the basic tax-free threshold has been reduced from 60% to 0%. The absorption of the basic tax-free threshold into the carbon offset potential will most likely create a significant increase in demand for projects that generate carbon credits, and could bridge the looming demand and supply issues currently present in carbon-offset mechanism proposed in the Paper (this issue is addressed in section 5.2 of this document).

A. Carbon-offset potential under the proposed carbon tax in South Africa

3. In studying the dynamics present in the demand and supply characteristics of the potential carbon-offset market, it is clear that the demand will significantly outweigh the ability of South African carbon offset projects to supply certified emissions reductions (CER), and that demand could in actual fact have been overestimated for the short to medium term of the proposed mechanism.

4. Although the Paper suggests that there are between 15.5 and 17 million tons of potential carbon dioxide equivalent (tCO2e) emission reduction available from the Clean Development Mechanism (CDM) projects alone (section 4.3 of the Paper), this needs to be put in context of the mechanisms being proposed in the paper, as well as the fact that the majority of these projects still need to be registered with CDM and achieve issuance.

5. As per the report delivered by Camco Clean Energy in 2012, entitled “Use of Carbon Offsets under a South African Carbon Tax Regime”, only around 4.4 million carbon credits have been issued from 9 projects in South Africa over the lifespan of the CDM. Further to this, 8 of these projects constitute industrial gas destruction, industrial energy efficiency or fuel switch projects – all of which are potentially excluded from qualifying as eligible projects, as per section 3.3 of the Paper. Following this approach, the amount of projects under CDM eligible for the proposed carbon offset mechanism will be reduced from 89 to 48 (of which only 3 projects have been issued with credits).

6. Taking into consideration the limitations imposed by the proposed mechanism, the carbon credits available from eligible South African CDM projects will be reduced to more or less 8.4 million – more than halving the estimated supply in the Paper.

7. It should also be taken into consideration that the majority of investment in emissions reduction initiatives will happen at an industrial process level, where the impact of the
investment will be the most effective, as it could potentially have significant up and down-stream benefits. The financial benefits that could be derived from existing processes could be a further catalyst for investment at an industrial process level, rather than in carbon offset projects. The administrative burden to implement these industrial process projects will also be minimal when compared to adhering to carbon offset project standards, with turnaround times and real savings being the biggest drivers for investment at this level.

8. This approach from industry could potential put the development and supply of CERs under further pressure, and place strain on the development of the envisaged green economy.

9. The absorption of the basic tax-free threshold into the potential carbon-offset, post phase one of the proposed carbon tax could be a solution to stimulating the development of projects that generate CERs in South Africa. It could consequently also provide a realistic time path within which these projects could be developed and reach the growth in market demand for CERs.

B. **Eligibility criteria of carbon-offset projects under the carbon tax**

10. As discussed in section 5.2 of the paper, the eligibility criteria proposed in the document could potentially be a major barrier to the development of CERs in South Africa, and significantly impact the demand and supply dynamics of carbon offsets in the local market.

11. Interim arrangements to operationalise issuance of carbon-offset credits by using existing international carbon-offset standards

12. Making use of the current standards in existence (i.e. CDM, VCS and Gold Standard) to issue CERs will go a great distance in ensuring credibility and confidence in the market with regards to the carbon offset mechanism. It will further also ensure that a degree of local familiarity and existing competence in these standards could be utilised to implement and expedite the process of developing CERs in South Africa.

13. Making use of these standards does however not come without its challenges. The ambiguity that has surrounded qualifying principles and terms such additionality, business-as-usual and permanence/sustainability has meant that the process has been open to subjective interpretations and introduced complexities that could have been resolved with a better definition and qualifying requirements for these terms. The cost and lengthy processes associated with these standards could also be a detractor for the additional tax-free threshold. This has specifically been proven within the energy efficiency tax incentive (section 12L of the Income Tax Act), where the complexity and investment required for conforming to the qualifying criteria may not merit the benefit that is being presented in the tax incentive.

14. As mentioned in section 5.2 and 5.5 of the paper, the cost, administrative burden, complexity and long turnaround times associated with these standards could prove to be a major hindrance to the success of the carbon offset mechanism in the market and could potentially result in the ultimate failure of the market – as has been the case in Europe with the European Union Emissions Trading Scheme (EU ETS).
15. It is suggested that the use of existing international carbon-offset standards be complemented with simplified and less burdensome administrative and qualifying criteria and definitions, with the emphasis being placed squarely on real emission reductions which will address the required policy outcome of a carbon tax. The additional requirements of social impact could count towards additional tax-free threshold benefits, but should not be significant driver of what the proposed carbon tax policy is set out to achieve.

C. **The role, functions, capacity and location of the administrating entity of the scheme**

16. Although we acknowledge the need and importance of the administrating entity, and its supporting structures, in order to execute the operational requirements around the carbon offset mechanism, it has been our experience that these administrating authorities (i.e. South African National Energy Development Institute (SANEDI) functioning within section 12I and section 12L of the Income Tax Act, and the Department of Science and Technology (DST) functioning within section 11D of the Income Tax Act) are ill-educated with regards to their role within the legislative environment, and do not understand the significance their actions (and lack of actions) have on the requirements of the legislation in which they function.

17. These administrative authorities further also tend to be under staffed, and accordingly, lack the necessary technical resources and competency to deal with the complex nature of these applications.

18. We submit that the success of the carbon offset mechanism, and the adoption rate of this mechanism, will to a large degree be dependent on the efficiency and competency of these administrative authorities.