



REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

TAXATION LAWS AMENDMENT BILL, 2022

16 January 2023

[W.P. – '22]

7.2 EXTENSION OF THE FIRST PHASE OF CARBON TAX FROM 1 JANUARY 2023 TO 31 DECEMBER 2025: THE ENERGY EFFICIENCY SAVINGS TAX INCENTIVE EXTENSION

[Applicable provision: section 12L of the Income Tax Act]

I. Background

In November 2013, government introduced the energy efficiency savings (EES) tax incentive in section 12L of the Act to encourage investments in energy efficient equipment and business practices by firms. Similar to all the tax incentives available in the Income Tax Act, when the EES tax incentive was introduced, it initially had a sunset date of 1 January 2020.

Accordingly, section 12L of the Act makes provision for a tax deduction from the taxable income of the taxpayer an amount equivalent to the monetary value of actual energy efficiency savings (kWh) achieved by the taxpayer in a year of assessment, subject to a certificate of approval issued by the South African National Energy Development Institute.

The EES tax incentive forms part of the revenue recycling measures under the Carbon Tax Act. In 2019, the EES tax incentive was extended for an additional 3 years from 1 January 2020 to 1 January 2023 to align it with the first phase of the carbon tax. Up to December 2020, about 265 project activities and EES were approved and contributed to emission reductions of around 26 million tonnes. In the 2022 Budget, it was proposed that the first phase of carbon tax and the EES tax incentive would be extended for 3 years from 1 January 2023 to 31 December 2025.

II. Reasons for change

Additional short-term tax relief will help aid the economic recovery by lowering the energy costs of businesses and stimulating new investments in energy efficiency. An extension of the EES tax incentive for three years from 1 January 2023 to 31 December 2025, complemented by real increases in the carbon tax rate during this period, will still maintain a dynamic incentive on the margin for companies to reduce greenhouse gas emissions and help to stimulate new energy efficient practices and industries.

III. Proposal

In line with the 2022 Budget proposal, it is proposed that the EES tax incentive be extended by three years from 1 January 2023 to 31 December 2025. As such, it is proposed that amendments be made in section 12L of the Income Act to extend the current sunset date from years of assessment ending before 1 January 2023 to years of assessment ending before 1 January 2026.

IV. Effective date

The amendments will come into operation 1 January 2023.

7.3 EXTENSION OF FIRST PHASE OF CARBON TAX FROM 1 JANUARY 2023 TO 31 DECEMBER 2025: ELECTRICITY PRICE NEUTRALITY COMMITMENT EXTENSION

[Applicable provision: Section 6(2)(c) and (d) of the Carbon Tax Act]

I. Background

The Carbon Tax Act came into effect on 1 June 2019. For the first phase of the carbon tax from 1 June 2019 until 31 December 2022, sections 6(2)(c) and (d) of the Carbon Tax Act provides a special tax deduction for electricity generators. Taxpayers are able to deduct payments of the electricity generation levy and additional purchases of renewable electricity from their carbon tax liability. The renewable electricity costs are calculated using the renewable premium rates for the different technologies, determined by the Minister of Finance by notice in the *Gazette*. The special tax deduction provision was introduced as a transitional support measure to cushion energy intensive users and households from higher electricity prices in the first phase of the tax. In the 2022 Budget Review, it was proposed that the first phase of carbon tax and the commitment to electricity price neutrality would be extended for 3 years from 31 December 2022 to 31 December 2025.

II. Reasons for change

The proposal for the extension of the electricity price neutrality commitment takes into account impacts of the COVID-19 health pandemic on the domestic economy and aims to provide temporary relief to taxpayers and consumers to support the economic recovery. South Africa also set out ambitious climate change mitigation commitments in the NDC for 2030, and signalled its intention to decarbonise and transition the electricity sector towards alternative, low carbon, clean energy sources and a more competitive market structure. The renewable energy premium deduction will encourage additional purchases of renewable electricity, help address electricity supply constraints and contribute towards achieving South Africa's emissions commitments.

III. Proposal

To incentivise the uptake of renewable electricity, while protecting households from higher electricity prices over the short term, it is proposed that the commitment to electricity price neutrality provided in section 6(2)(c) and (d) of the Carbon Tax Act is extended by three years, from 31 December 2022 to 31 December 2025.

IV. Effective date

The amendments will come into operation 1 January 2023.

7.4 LIMITATION OF ELECTRICITY PRICE NEUTRALITY DEDUCTIONS ELECTRICITY GENERATION FROM FOSSIL FUELS

[Applicable provision: Section 6(2) of the Carbon Tax Act]

I. Background

In terms of section 6(2) of the Carbon Tax Act, taxpayers can claim a tax deduction for payments of the electricity generation levy and additional renewable electricity purchases against their carbon tax liability. The following announcements were made in the 2022 Budget Review.

- Limitation of deduction to fuel combustion emissions tax liability

Section 6(2) provides the formula for calculating the final tax payable by electricity generators after deducting the electricity generation levy payment and the renewable electricity purchases. Section 6(2)(b) defines “A” in the formula as the amount of tax payable in respect of a tax period determined in terms of subsection (1). “A” is the gross tax liability for all emissions categories, that is, fuel combustion, industrial process and fugitive emissions. Therefore, the tax deduction for the electricity levy payment and purchases of renewable electricity applies to the total carbon tax liability of a company for greenhouse gas emissions from combustion, industrial processes and fugitive emissions after the tax-free allowances are deducted in subsection (1).

Taxpayers submitted comments on the 2021 TLAB requesting clarity on whether the deduction is applicable to the total carbon tax liability of a taxpayer or only the combustion emissions tax liability. For example, a taxpayer may have energy combustion emissions from other activities such as domestic aviation, as well as process and fugitive emissions. Since the other emissions are not directly related to stationary combustion emissions from electricity generation, there was a view that the electricity price neutrality commitment should be limited to the tax liability for emissions from stationary combustion emissions activities only and excluding non-stationary emissions categories. To address this concern, it was proposed in the 2022 Budget Review, that this deduction be limited to the carbon tax liability for the fuel combustion emissions of a taxpayer.

- Clarification related to taxpayers generating electricity from fossil fuels

To provide clarity to taxpayers on the qualifying activities for which this claim can be made, it is proposed that changes be made to section 6(2) of the Carbon Tax Act to clarify that taxpayers would qualify for a deduction if they generate electricity from fossil fuels and conduct fuel combustion activities under the Intergovernmental Panel on Climate Change (IPCC) Code 1A1 energy industries, 1A2 covering manufacturing industries and construction and 1A4 for other sectors (including heat and electricity recovery from Waste).

II. Reasons for change

- Limitation of deduction to fuel combustion emissions tax liability

Applying the formula in Section 6(2) of the Carbon Tax Act, shows that mathematically the final tax liability for a taxpayer is the same under both scenarios, that is, the deduction against the total carbon tax liability or only the combustion emissions liability. If changes are proposed, this could mean revisions to the formulas in Section 6, which could introduce further complexities. No legislative changes are therefore proposed.

- Clarification related to taxpayers generating electricity from fossil fuels

To remove any ambiguity in the legislation, clarification that “taxpayer in respect of generation of electricity from fossil fuels” in Section 6(2) means activities conducted under the IPCC Code 1A1 energy industries, 1A2 covering manufacturing industries and construction would be necessary and 1A4 for other sectors (including heat and electricity recovery from Waste).

III. Proposal

- Clarification related to taxpayers generating electricity from fossil fuels

Amendments are proposed to section 6(2) of the Carbon Tax Act to clarify that “taxpayer in respect of generation of electricity from fossil fuels” by adding conducting activities under the IPCC Codes 1A1 energy industries, 1A2 covering manufacturing industries and construction and 1A4 for other sectors (including heat and electricity recovery from Waste).

IV. Effective date

The amendments will come into operation on 1 January 2023.

7.5 LIMITING CARBON SEQUESTRATION DEDUCTIONS TO ACTIVITIES WITHIN THE OPERATION CONTROL OF THE TAXPAYER

[Applicable provision: Section 6(4) of the Carbon Tax Act]

I. Background

Amendments were proposed in the 2021 draft Taxation Laws Amendment Bill to limit the carbon sequestration deduction to forestry plantations. After reviewing public comments, the bill was amended to expand the scope of the carbon sequestration deduction to include emissions sequestered in harvested wood products for the paper and pulp activities under IPCC code 1A2D. Further concerns were raised on the certification and verification of sequestered emissions where forestry management and harvested wood products are owned by third parties. In the 2022 Budget Review, amendments were proposed to introduce a limitation on the deduction for forestry management and harvested wood product sequestration activities to only those activities within the operational control of the taxpayer and to exclude sequestration activities managed by third parties.

II. Reasons for change

Taxpayers conducting electricity generation activities in the paper and pulp sector are able to deduct emissions sequestered in forestry plantation and harvested wood products from their energy related emissions. Some of these activities are managed by third parties, and it would be difficult to monitor and verify these activities. The proposed amendments will tighten the sequestration deduction and curtail the possibility of double claims for sequestration by both the third-party taxpayer that undertook the sequestration and the primary taxpayer on whose behalf the sequestration was conducted.

Limiting this deduction to activities within the operational control of the taxpayer will help to address potential administration challenges where activities are not within the taxpayer's operational control and to curb potential abuse.

III. Proposal

It is proposed that changes are made to Section 6(4) of the Carbon Tax Act to limit eligible sequestration activities to activities within the operational control of the taxpayer conducting activities in terms of IPCC code 1A2D for pulp, paper and print and 1A2j for wood and wood products.

IV. Effective date

The amendments are deemed to have come into operation on 1 January 2022.

8. CUSTOMS AND EXCISE ACT

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8.1 VAPING: TAXATION OF ELECTRONIC NICOTINE AND NON-NICOTINE DELIVERY SYSTEMS

[Applicable provision Section 58, Schedule No 1 and Schedule No 6 of the Customs & Excise Act, 1964]

I. Background

New generation products (NGPs) which include electronic nicotine delivery systems (ENDS) and electronic non-nicotine delivery systems (ENNDS) have been introduced in the market as harm reduction or reduced risk products compared to traditional tobacco products. These products are battery-powered devices that do not burn or use tobacco leaves, but instead vaporise e-liquid solutions to create an aerosol which the user then inhales. Even though many of the long-term health effects of ENDS use are still unknown, there is growing evidence to demonstrate that these products are not harmless. ENDS on their own carry health risks (World Health Organisation, 2021).

II. Reasons for change

The World Health Organisation (WHO) has advised governments that taxes should be applied to these products, in line with national standards, to prevent uptake, particularly among children and