



INFORMATION ALERT:

SOUTH AFRICAN BUDGET 2009: ENVIRONMENTAL FISCAL REFORM AND TAXATION

The South African Minister of Finance, Trevor Manuel, delivered his 2009 Budget Speech to Parliament on Wednesday 11 February 2009. The Budget links the environment and the economy by noting that, over the long term, environmental considerations will affect the sustainability of economic growth and, with this in mind, government intends to promote efficient use of energy and water resources by producers and households, along with measures to mitigate the effects of climate change.

The 2009 Budget addresses environmental fiscal reform in various ways, including through the following key measures:

- Introducing incentives for cleaner production (energy efficiency).
- Increasing the levy on plastic bags.
- Introducing taxation of incandescent light bulbs.
- Proposing a tax incentive for carbon credits from Clean Development Mechanism.
- Increasing motor vehicle *ad valorem* excise duties.
- Increasing international air passenger departure tax.
- Increasing fuel levies.
- Providing ZAR 45 million to Working for Energy, a programme which uses biomass to generate electricity.
- Providing ZAR 30 million to support research on climate change mitigation and adaptation strategies to inform the development of a national climate change strategy.
- Implementing, as from 1 July 2009, the electricity levy announced in the 2008 Budget. The levy, which is intended as the first step towards the introduction of a more comprehensive greenhouse gas emissions-based carbon tax, is a tax of ZAR 0.02c/kWh levied on the sale of electricity generated from non-renewable sources, to be collected at sources by the producers / generators of electricity. The electricity levy acts as a disincentive to fossil-fuel based power generation.
- Providing ZAR 1 billion to the Department of Water Affairs and Forestry for the installation and rehabilitation of 71 regional bulk water and sanitation schemes.

Most of the environmental interventions proposed in the 2009 Budget will take effect from the beginning of the 2010/2011 fiscal year.

The Budget notes that 2009's tax proposals are intended:

- to meet the requirement of the *fiscus*, while supporting consumer and business confidence in the context of a weakening economy; and,
- to support environmental initiatives that promote sustainable development, energy efficiency and investment in new technologies.

The following tax proposals which are likely to impact the environment positively are included in the 2009 Budget

Carbon credits from Clean Development Mechanism projects

In his speech the Finance Minister noted that South Africa "should encourage companies to take advantage of the clean development mechanism established in the Kyoto Protocol", and that, consequently, "a favourable tax treatment will...be introduced for the recognition of income derived from the sale of emissions reductions, as certified through this mechanism".

Noting that South Africa's greenhouse gas emissions rank in the top twenty in the world, contribute 1.8% to global emissions and to 42% of Africa's emissions, the Budget Review mentions the increasing prominence of market-based instruments in addressing environmental concerns,¹ and notes that appropriate domestic policy intervention will be required to ensure that mitigation and adaptation measures to address climate change are implemented.

Certified Emissions Reductions (CERs) generated by Clean Development Mechanism project activities implemented in South Africa represent one such market mechanism. However, to date, there has been uncertainty with regard to the South African income tax treatment of CERs. The Budget Review indicates that this uncertainty may have contributed to the slow take-up of CDM projects in South Africa.²

In light of this factor it is proposed:

- that income derived from the disposal of primary CERs (pCERs) be tax-exempt or subject to capital gains tax instead of normal income tax; and,
- that secondary CERs (sCERs) be classified as trading stock, and taxed accordingly.³

It is likely that this tax treatment, particularly of pCERs, will result in significant savings in CDM project development thus operating as an incentive to the industry in South Africa.

It is important that the comments made by the Finance Minister, the views on climate change expressed in the Budget Review and the abovementioned tax proposals for CERs are made against the background of:

¹ Market mechanisms include taxes, charges and tradable permits and use the market price mechanism to deter environmentally detrimental activity and encourage improved environmental management practices.

² There are currently 14 Registered CDM projects in South Africa, 12 of which are located in the energy industries sector. See: www.dme.gov.za

³ pCERs are those purchased directly from a CDM project activity. Part of the *rationale* for Treasury' proposed treatment of pCERs is the understanding that the majority of CERs changing hands in South Africa will be pCERs and that such transactions should be incentivised. sCERs represent an on-sale of pCERs, e.g., into the brokered carbon market.

- South Africa's pending Climate Change Policy Summit, scheduled to occur from 3 to 6 March 2009, which is intended to determine the country's climate change policy framework into the future;⁴ and,
- the urgency in the international negotiations for a future global climate change legal regime which are focused on the Fifteenth Conference of the Parties to the United Nations Framework Convention on Climate Change, scheduled for December 2009, in Copenhagen, Denmark.

Warburton Attorneys welcomes the abovementioned proposed tax treatment of CERs in South Africa. Members of our *Carbon Markets Legal Unit* have played a leading role in ongoing interventions made by the Tax & Legal Working Group of the South African CDM Industry Association (SACDMIA), with the South African National Treasury's Tax Policy Unit *inter alia* on the question of the tax treatment of CERs in South Africa. The CER tax proposal contributes to certainty in the South African CDM market and should be taken as an indication of the South African government's commitment to the CDM. Warburton Attorneys collaborates closely with IMBEWU Sustainability Legal Specialists (Pty) Ltd., which currently performs the Secretariat function for the SACDMIA.

Incentives for cleaner production (energy efficiency)

The Budget Review notes that a number of environmental statutes and regulations require the private sector to eliminate inefficiencies in the use of energy, water and raw materials and, to complement these measures market-based instruments are playing a greater role in these environmental interventions. While current legislation provides for a three-year, 50:30:20% accelerated depreciation allowance for investments in renewable energy and biofuels production, the 2009 Budget proposes to introduce further incentives for energy-efficient investment. The proposal is that investments by companies in energy-efficient equipment should qualify for an additional accelerated depreciation allowance of up to 15% on condition that there is documentary proof of the resulting energy efficiencies, which proof is certified by the Energy Efficiency Agency.

Plastic bag levy

The levy on plastic shopping bags, introduced in the in 2004/05 Budget, currently stands at ZAR 0.03 per plastic bag.⁵ The 2009 Budget proposes to increase the levy to ZAR 0.04 per plastic bag from 1 April 2009.

Taxation of incandescent (filament) light bulbs

The 2009 Budget Review proposes to introduce an environmental levy on incandescent light bulbs to promote energy efficiency and reduce electricity demand. Energy-saving (compact fluorescent) light bulbs last longer than the traditional variety, require one-fifth of the power, and result in lower greenhouse gas emissions. The proposed environmental levy is set at ZAR 3.00 per incandescent bulb, to be levied at the manufacturing level and on imports from 1 October 2009.

Motor vehicle ad valorem excise duties

Policy measures to address the environmental and social costs associated with the transport sector, such as reforms to vehicle and fuel taxation, seek to promote fuel efficiency, limit the rapid growth of the number of vehicles on the roads and encourage the use of public transport. Improved fuel efficiency is also important in

⁴ See: www.deat.gov.za

⁵ Approximate exchange rate: ZAR 9.50 : US\$ 1.00

curbing the growth in greenhouse gas emissions. Consequently, the Budget Review proposes to adjust the existing *ad valorem* excise duties on motor vehicles to take account of carbon dioxide emissions, as an environmental criterion from 1 March 2010. In particular, it is proposed that the "luxury" *ad valorem* excise duty on the sale of new motor vehicles be reduced while an additional tax is imposed on carbon dioxide emissions, for new motor vehicles, based on the grams of carbon dioxide emitted per kilometer by the vehicle

International air passenger departure tax

The international air passenger departure tax, which stands at ZAR 120.00 per passenger on flights to international destinations and ZAR 60.00 on flights to Southern African Customs Union member states, was last raised in the 2005/06 Budget. The 2009 Budget Review proposes to increase these amounts to ZAR150.00 and ZAR 80.00 respectively from 1 October 2009.

General Fuel Levy

The 2009 Budget Review proposes to increase the general fuel levy on petrol and diesel by ZAR 0.23 and ZAR 0.24, respectively, from 1 April 2009. It is estimated that this increase will add a approximately ZAR 4.9 billion to the *fiscus*, annually.

Please contact Warburton Attorneys should there be any queries in regard to the contents of this Information Alert.

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