

BUSA COMMENTS ON TREASURY RESPONSES

June 2018

2. Policy Issues and Responses

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2.1	South Africa's NDC Commitment, GHG emissions trajectory and the carbon tax	<p>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, stakeholders argued that a lower level of economic growth does not obviate the need for a carbon tax to incentivise further reductions in overall greenhouse gas (GHG) emissions. It is also recognised that the peak, plateau and decline (PPD) trajectory is a range, as indicated by the 398 to 614 MT CO₂e in the national policy and Nationally Determined Contribution (NDC), and South Africa's emissions are significantly above the lower PPD trajectory range.</p> <p>Other stakeholders suggest that since 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 NDC before 2025. There were suggestions for a review of South Africa's climate change commitments in light of the current economic environment of low economic growth and high unemployment.</p>	<p>Noted. South Africa ratified the Paris Agreement and submitted its NDC on Adaptation, Mitigation as well as finance and investment requirements for both. For the NDC, South Africa transitioned its international mitigation commitment from a relative deviation from business as usual to an absolute peak, plateau and decline GHG emissions trajectory. This means that emissions by 2025 and 2030 should be in the range between 398 and 614 MT CO₂-eq as defined in national policy.</p> <p>The NDC requires that our GHG emissions peak in 2020 to 2025, plateau for a ten-year period from 2025 to 2035 and decline from 2036 onwards. The Carbon Tax Bill gives effect to the "polluter-pays-principle". The carbon tax will assist, in a least cost manner, in reducing GHG emissions and ensuring that South Africa will meet its NDC commitments as part of its ratification of the 2015 Paris Agreement. Thus, the carbon tax is an essential element of South Africa's commitment to the Paris Agreement, as part of a package of measures to mitigate climate change. The carbon tax is intended as an instrument to help drive down emissions in a cost effective and dynamic way over the medium to long term.</p> <p>Noted but disagree. As noted in the various policy documents: "The main</p>	

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			<p>aim of the carbon tax is to put a price on the environmental and economic damages caused by excessive emissions of greenhouse gases. A secondary aim is to change the behaviour of firms and consumers, by encouraging uptake of cost-effective, low-carbon alternatives. The fact that the current levels of emissions might be within the target range does not mean the carbon tax should be zero or negate the need for a carbon tax. Analysis has shown that GHG emissions are closely related to GDP growth and if we do not take precautionary action GHG emission will likely exceed the target range by as early as 2025.</p> <p>The September 2016 Carbon Tax Modelling report by the World Bank also noted that: “The proposed carbon tax would lead to an estimated <u>decrease in emissions of 13 to 14.5 percent by 2025 and 26–33 percent by 2035</u> 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 (which is more or less in line with the PPD range) 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”. (Page 21)</p>	
2.2	Carbon tax rate - is too low	Several stakeholders, including NGOs and academia, were concerned that the Bill does not adequately implement the “polluter-pays principle” or reflect the urgency of the risk posed. They stated the Bill will not sufficiently promote a meaningful reduction of GHG emissions and that this failure contradicts the	Noted. Given the low effective carbon tax rate and tax-free allowances, there is a compelling case to consider an upward adjustment of the current tax rate of R120/tCO ₂ e to more fully reflect the externality costs of GHG emissions and climate change. The annual adjustment of the rate as per the current	

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		<p>Constitutional right to an environment not harmful to one's health or well-being, and the duty to take reasonable measures to prevent environmental pollution. To operationalize the "polluter-pays principle", it is argued that the effective tax rate will have to increase in real terms for a significantly longer period to make a material difference to South Africa's GHG emissions. It is suggested that the proposed tax rate of R120 per ton of CO₂e (about US\$10) is well below the carbon tax rates of other countries and falls short of the required range by the High-Level Commission on Carbon Prices which concluded that the explicit carbon-price level consistent with the Paris Agreement temperature target should be at least US\$40–80/tCO₂ by 2020 and US\$50–100/tCO₂ by 2030.</p> <p>It is 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 follow a more aggressive increment to enable a suitable price of near US\$40 before 2030, or at a level that is likely to adequately drive significant behavioural change. To align with the High-Level Commission on Carbon Pricing's conclusion based on the Paris Agreement temperature target, to which South Africa is a signatory, the carbon tax rate would need to be R473 per ton of CO₂e by 2020. In addition, it is suggested the carbon tax rate should be adjusted on an annual basis considering our NDC commitments.</p> <p>Some stakeholders are of the view that for the first phase of the carbon tax, the</p>	<p>proposal in the bill of CPI plus 2 per cent for the first phase will therefore be maintained. This considers the need to maintain the real value of the tax and to create a stronger price signal on the margin to drive behaviour change and emissions reductions by both producers and consumers over the short, medium and long term. It is important to note the experience of other jurisdictions. For example, California increases their tax rate by 5 per cent above inflation.</p> <p>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 changes required to transition to a low carbon economy.</p> <p>Further rate adjustments will be informed by the integrated review process towards the end of the first phase of the carbon tax. South Africa's NDC commitment limits emissions in 2025 and 2030 to between 398 and 614 Mt CO₂e, implies that the country will need to submit progressively more ambitious goals to guarantee a low-carbon future, so South Africa is obliged to develop and implement measures and systems that will enable the achievement of its commitment.</p> <p>Section 5 of the carbon tax bill specifies the headline, marginal tax rate of R120/tCO₂e and provides for annual increase to the nominal carbon tax rate by the rate of inflation plus 2 per cent for the first phase of the tax up to 2022, and</p>	

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		tax rate should be fixed at R120/ton CO2e with motivation for subsequent adjustments to the rate while others suggested that changes to the tax rate should be limited to inflationary adjustments.	inflationary adjustments thereafter, considering the review process.	
2.3	Carbon tax modelling and socio-economic impact	Initially, questions were raised on the carbon tax modelling undertaken on the carbon tax and the need for more detailed analysis on the impacts of the carbon tax on electricity prices, emissions intensive trade-exposed sectors and revenue recycling measures. The DTC's view on the need for further modelling to be undertaken to determine the potential impacts and recycling options, as well as implications for employment, was also raised. Some stakeholders suggested that some of 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.	<p>Noted. 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, i.e. the revenue recycling measures. These modelling studies were presented, explained and debated at a public workshop in November 2016 and the report entitled: "Modelling the Impact on South Africa's Economy of Introducing a Carbon Tax" is publicly available. The results of these studies provide a reasonable understanding of environmental and economic impacts of a carbon tax and helped with the decision-making process.</p> <p>Overall, the economic modelling conducted based on the current policy design shows that the carbon tax will have a significant impact on reducing South Africa's GHG emissions and would lead to an estimated decrease in emissions of 13 to 14.5 per cent by 2025 and 26 to 33 per cent by 2035 compared with business-as-usual. The carbon tax will have a marginal impact on the economy's average annual growth rate</p>	

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			<p>which will be 0.05–0.15 percentage points below business as usual. The carbon tax would make an important contribution towards reaching South Africa’s NDC commitments. The potential adverse impacts of the carbon tax are likely to be overestimated in the study due to the inability to model certain tax-free allowances such as the offsets, performance and trade exposure allowances, while the benefits of reducing emissions including reduced costs of adapting to the impacts of climate change and health co-benefits which were not quantified and included in the model.</p> <p>It should be noted that the modelling assumes that the tax-free allowances will be gradually phased out and that 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.</p>	
2.4	Long term policy uncertainty and timing of the introduction of the tax	<p>Some stakeholders argue that the lack of policy certainty on the carbon tax regime beyond 2022 will impact business decision making with respect to future investments and technology choices. Some are also 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.</p> <p>There was support for the policy certainty provided on the carbon tax, both in the Second Draft Carbon Tax Bill</p>	<p>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. The 2017 Draft Carbon Tax Bill also clarifies the carbon tax rate adjustments for the initial and subsequent phases, considering the review process.</p> <p>Beyond the first phase, 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</p>	

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		<p>circulated for comments in December 2017 and in the budget speech in February 2018. It is argued by some stakeholders 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.</p> <p>Some stakeholders have suggested a phased approach to the implementation of the carbon tax so that taxpayers will have more time to adjust to the carbon tax. For example, the first phase could include only fuel combustion emissions, a second phase could then add process emissions with the final phase adding fugitive emissions. It is also recommended that the duration of the first phase should be for a period of five years.</p>	<p>depend on the economic circumstances and emissions mitigation efficiency achieved. The review will consider 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. This review and possible adjustments to the tax rate and tax-free thresholds will also take into account developments with regards to the carbon budgets.</p>	
2.5	Policy alignment with the carbon budgets	<p>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.</p> <p>Some stakeholders raised concerns that should the carbon tax be converted into a penalty applied to emissions exceeding allocated carbon budgets, this would mirror a cap-and-trade system with grandfathering of emission allowances. It is argued that since the carbon tax is a market-based instrument, it can be implemented in parallel with development of a regulatory „Mitigation</p>	<p>Noted. The carbon tax is envisaged as a broad-based carbon pricing mechanism to provide the least- cost option to incentivise GHG emissions reduction and to address climate change. It will be phased in gradually and will provide clear signals for investment decision-making. Additional measures include regulations, standards, the carbon budgets, tax incentives and budget allocations.</p> <p>The DEA and NT undertook a study on the Options for the Alignment and Integration of the carbon tax and Carbon Budget Instruments through the World Bank PMR in 2016. The report has been</p>	

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		<p>System" 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.</p> <p>Some stakeholders also supported the proposal by the NT and DEA that any amendment to the tax design should be considered after the integrated review of carbon reduction instruments, which will be undertaken after the first phase of implementation of the carbon tax. It is suggested that the review of both instruments should be included in the Bill.</p> <p>There are some views from stakeholders on the design of the alignment options including:</p> <ul style="list-style-type: none"> • It is recommended that a carbon tax is applied on all emissions, with a lower rate for those emissions within company carbon budgets, and a significantly higher penalty rate for emissions exceeding the budget to incentivise real mitigation action, especially at the low prices of the carbon tax; • Having a carbon tax where there is a basic tax-free allowance equal to the carbon budget (with no further allowances for trade exposure or performance) such that the company would only have a carbon tax liability on those emissions in excess of the budget; and • Regarding the current carbon budget allowance of 5 per cent for the first phase of the carbon tax, it is recommended that firms that keep within 	<p>made publicly available. As part of the study, various stakeholders were consulted on the alignment options. In principle, the DEA and NT have agreed to an alignment approach where the carbon tax will be levied on emissions above the absolute carbon budgets taking into account the stringency and robustness of the carbon budgets. DEA is finalising the methodology for determining the level of the budgets. The options for integration of the two instruments as well as the possible design options including the possibility for the two instruments to operate independently are noted.</p> <p>It should be noted that 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. 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.</p>	

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		the GHG emissions regulated limits are simply in compliance and should not be given the extra 5 per cent tax-free allowance for carbon budgets under the carbon tax.		
2.6	Competitiveness Impacts and Trade exposure allowance	<p>Some stakeholders argued that South Africa will not be able to compete with other markets such as China and Brazil with the introduction of the carbon tax and were of the view that the trade exposure allowance is insufficient to address the vulnerability of local industries.</p> <p>It is suggested that the proposed relief for trade-exposed sectors applies only to direct emissions which results in reduced competitiveness due to increased electricity prices if all or a portion of the carbon tax is passed through to electricity consumers for sectors with significant indirect emissions. It is recommended that the use of a combination of border tax adjustments and adjustments to carbon tax rebates should be imposed on basic commodities for exports to jurisdictions with no carbon tax.</p>	<p>Noted. The design of the carbon tax provides significant tax-free allowances including the basic tax- free allowance for all sectors (i.e. Allowable emissions), process emissions allowances; and a trade exposure allowance, to address potential competitiveness concerns. Over the past decade an increasing number of countries including developing economies have proposed carbon pricing policies as part of their NDCs under the Paris Agreement and have implemented carbon pricing policies. For example, China implemented a national ETS for the power generation sector in December 2017. Other countries that have implemented carbon taxation include:</p> <ul style="list-style-type: none"> • Mexico has a carbon tax since 2014 which applies to fossil fuels; • Colombia implemented a carbon tax on transport fuels in 2017; • Brazil, Ivory Coast and Morocco are exploring a carbon tax; and • Singapore and Argentina are scheduled to implement a carbon tax in 2019. <p>These measures are recognised as important policies as part of climate policy packages that help to price GHG emissions and create incentives for changes in the behaviour of both consumers and producers that drive</p>	

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			<p>reductions in GHG emissions in a cost effective, flexible manner. As the coverage of carbon pricing measures expands globally, the impacts on industry competitiveness are likely to be reduced and the benefits and investment opportunities will increase for new, low carbon industries.</p> <p>Even without taking into account carbon pricing in other countries, the 2016 carbon tax modelling suggests that concerns over the competitiveness impacts of the carbon tax are overstated. It suggests that overall exports in 2035 could be 3.5 percent higher with the introduction of the carbon tax. (P.22)</p> <p>The trade exposure allowance of 10 per cent was initially designed as a company-based allowance. Following consultations on the 2015 Draft Carbon Tax Bill, the proposals from business were accepted and the allowance was changed from a company based to sector-based allowance. It was argued that a sector-based allowance will be more equitable and simpler to administer than the company-based approach. In collaboration with BUSA, the allowance was redesigned and key industrial sectors such as mining, and iron and steel are likely to qualify for the full trade exposure allowance of 10 per cent. The draft Trade Exposure Regulations outlining the sectors and / or subsectors and level of allowances will be published shortly for public consultation and finalisation.</p>	

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2.7 2.7.1	Revenue Recycling Earmarking of revenues	<p>Stakeholders were of the view that the current Bill does not guarantee carbon tax revenues raised will be ring-fenced and that the Bill should include specific earmarked revenue recycling programs. There was support for the additional revenue recycling measures, such as the expansion of free basic electricity, funding for alternative energy sources, and the expansion of public transport and it was suggested that these measures should be included the Bill.</p> <p>Several suggestions were made by stakeholders for the use of revenues from the carbon tax including:</p> <p>Targeted revenue recycling for the benefit of rural agricultural areas where there is biomass based renewable energy options which can assist both in GHG emission reduction and job creation in socio-economically poorer regions of the economy;</p> <p>revenue could be used to facilitate investments in co-processing of waste to give effect to integrated waste management, circular economy as well as mitigating coal-based GHG emissions from cement kilns;</p> <p>channelling revenues to support small and emerging businesses and climate change mitigation start-ups; and</p> <p>revenues should be earmarked to provide finance or loans for community-based renewable energy installation in low income areas.</p> <p>Some stakeholders were of the view that consideration should be given to a jobs and competitiveness programme that</p>	<p>Not accepted</p> <p>In general, the rigid earmarking of specific tax revenue streams is not in line with sound fiscal management practices. Earmarking of revenues introduce rigidities into the budgetary process, does not allow for modifications for revenues to be allocated to address pressing government priorities and could result in either revenue under or over allocation.</p> <p>Accepted.</p> <p>However, based on the economic modelling analysis undertaken, the efficient and effective recycling of revenue will be vital for the required structural adjustment to support the transition to a low carbon, climate resilient economy. The three categories of revenue recycling mechanisms proposed are:</p> <ul style="list-style-type: none"> • tax shifting: reducing or not increasing other taxes (initially a credit for the electricity generation levy as per 2017 Draft Carbon Tax Bill. This levy can be phased down during the second phase) • tax incentives: including the Energy efficiency savings tax allowance • “soft” earmarking (on budget allocations): enhanced free basic energy / electricity programme, improved public transport <p>The credit for the renewable energy premium is already incorporated in the Draft Carbon Tax Bill. In the absence of a carbon tax, the electricity levy is currently fulfilling the twin objectives of promoting energy efficiency and</p>	

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		<p>ensures assistance to poor households and transitional assistance for mitigation by energy-intensive and trade exposed firms against agreed plans.</p> <p>It was requested that the National Treasury provides a schedule of the carbon tax revenues collected and the anticipated allocation of this revenue.</p>	<p>indirectly pricing GHG emissions. To ensure the effective pricing of GHG emissions without double taxation, upon the introduction of the carbon tax, a credit or reduction of the electricity generation levy is proposed for the first phase.</p> <p>Other revenue recycling measures will be done through on budget allocations in the usual transparent way such allocations are done. Additional suggested revenue recycling measures proposed are noted and will be considered, should there be surplus revenue from the carbon tax after the afore- mentioned revenue recycling measures, as part of the on-budget support mechanisms.</p> <p>Noted. National Treasury already publishes tax revenue and spending information. This information can be made available to taxpayers.</p>	
2.7.2	Energy Efficiency Savings Tax Incentive (Section 12L)	<p>Some stakeholders suggested that the S12L Energy Efficiency Savings (EES) 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).</p>	<p>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. In parallel, a review of the EES tax incentive will 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. It should be noted that this measure was specifically introduced as one of the options for potential revenue recycling, even though the carbon tax had not yet been introduced. However, it is reasonable to assume that the EES tax</p>	

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			incentive should come to an end sometime in the future.	
2.8 2.8.1	Electricity price neutrality, electricity levy, IRP and Electricity Sector Market Structure Electricity price neutrality – electricity generation levy for 2 nd phase	Stakeholders requested clarity on the status of the electricity generation levy and the carbon tax beyond the first phase of the carbon tax. It is argued that the cumulative impact of other environmental taxes including the electricity levy must be considered as this could be a “double tax” and will burden both consumers and organisations.	<p>Noted. It is important to note that the real electricity tariffs in South Africa have been stagnant or declining for most of the period between the late 1980s and 2007 due partly to excess generation capacity. This promoted the inefficient use of electricity due to very low electricity prices, provided little or no incentive for improving the efficiency of energy use and therefore placing the economy on a more energy and carbon intensive growth path. Besides the relatively low electricity prices from a „pure“ financial perspective, no consideration was given to take into account the full economic costs of generating electricity, including the environmental damage costs associated with local air pollution and GHG emissions.</p> <p>Since the beginning of 2008, it became clear that the demand and supply balance had shifted and the need for additional and cleaner electricity generation capacity. Significant increases in electricity prices since 2008 have been noted as a concern, although electricity prices in South Africa are still relatively modest, and the intermittent load-shedding has impacted negatively on economic growth. The electricity generation levy was introduced as one of a range of demand side management tools to deal with some of the supply challenges facing the electricity sector as well as a proxy carbon tax. Some of the revenues from this levy are used to fund rehabilitation of roads damaged</p>	

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			<p>due to coal haulage.</p> <p>It is clear that the transition to a period of more cost reflective tariffs, including environmental costs is necessary, but will have to be carefully managed.</p> <p>It should be noted that the electricity levy is currently 3.5 c/kWh. NERSA allows Eskom an effective higher pass through due to losses in transmission and distribution. Assuming a 70 per cent tax-free allowance, i.e. the basic tax-free allowance plus the offset allowance of 10 per cent, would translate into an additional 3.77 cent per kWh. Hence electricity price neutrality during the first phase could be achieved through a combination of a lower electricity levy and a credit for the renewable energy premium.</p> <p>Section 6(2) of the bill was previously amended to allow a credit for the electricity generation levy payable against the carbon tax liability of all electricity generators. The EESes, plus the EES tax incentive, would leave very little if any additional revenue for further recycling during the first phase. It is important to note that both the electricity generation levy and the renewable energy premium seek to implicitly price GHG emissions but does not aim to explicitly price externalities into the final price of electricity. This is the intention of the carbon tax.</p> <p>The combined effect of the implicit and explicit carbon price will however need to be considered, but this is unlikely to</p>	

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			<p>reflect the full marginal external costs of climate change in the near future. The commitment to ensure that the carbon tax does not impact the electricity price holds for the first phase, primarily to provide relief for sectors currently in distress, such as mining and steel. In light of efforts to progress towards more fully internalizing the costs and impacts of GHG emissions, to help achieve our GHG emissions goals outlined in the NDC, the National Treasury will consider the combined impact of the explicit carbon tax and the electricity levy and the options for phasing down the electricity generation levy at the beginning of the second phase of the carbon tax. This will take into account the on-budget programmes including the rehabilitation of roads damaged due to coal haulage that is covered by the electricity levy.</p>	
2.8.2	Electricity Market Structure, Integrated Resource Plan and Renewable Energy Premium	<p>Some stakeholders argue that due to the monopolistic and regulated structure of South Africa's electricity sector, it means the future electricity mix will be driven mainly by the Integrated Resource Plan (IRP) and a carbon tax will likely not result in the envisaged behaviour change.</p> <p>There are concerns from stakeholders who argue that renewable energy premium credit is already integrated into Eskom's pricing through the multi-year price determination and providing a further tax deduction for the premium is effectively a double reward of the price difference to Eskom.</p>	<p>Noted, but disagree. Pricing GHG emissions through a carbon tax gives effect to the polluter pays principle and provides the necessary incentives through the price mechanism for the uptake of more efficient, lower carbon and cleaner fuels. It is an important component of the country's climate change policy together with the IRP, and other policy measures, which sets out the plan for electricity generation. The advantages of a carbon tax as a regulatory instrument is that it provides price certainty and makes clean energy options, both grid and off-grid, more cost competitive with fossil-based electricity, rather than choosing technology options which could be more expensive and unaffordable for the country. It is important to look at the „actual“ implicit</p>	

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			<p>carbon price of the current electricity supply and not at the simulated „implicit“ price of an energy mix not yet implemented. An explicit, economy wide carbon price that includes the electricity sector is therefore necessary.</p> <p>The proposed renewable energy premium credit, to the extent that this would be possible to implement, aims to cater for the implicit carbon price for renewable energy investments. Combined, these policy instruments are crucial to promote structural adjustments in the economy and help to facilitate the transition to a low carbon economy.</p> <p>The stakeholder views on the current electricity market structure and the need for restructuring of the electricity sector to ensure the carbon price is more efficient is noted.</p> <p>Noted. The economic case for the renewable energy credit and potential double benefits for electricity generators is therefore noted.</p>	
2.9 2.9.1	Liquid fuel – Transportation Carbon tax pass-through	The industry has submitted a proposal to the NT on an approach and methodology for the carbon tax pass-through mechanism for the liquid fuels sector. The proposal that aims to pass through the carbon tax costs associated with the price-controlled petroleum products (LPG, petrol, illuminating paraffin and diesel) is under discussion, where there is a direct link between the quantum of the pass- through to the relative carbon performance (benchmark) of a particular facility. This is viewed by some stakeholders as	<p>Noted. Given the regulated nature of fuel prices in South Africa, and that refineries are unable to recover these costs; a limited transparent and equitable pass through mechanism would be considered. The Industry association submitted a proposal for the pass-through mechanism to the NT for consideration. The pass-through mechanism will be finalised shortly.</p>	

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		imposing a penalty on facilities that may be under performing from a carbon perspective.		
2.9.2	Taxation of stationary and non-stationary emissions from liquid fuels	<p>To address potential double taxation of liquid fuels, the carbon tax payable formula provides for a deduction of emissions from all liquid fuels utilised by an entity (including petrol and diesel), which would be taxed through the fuel levy. Stakeholders suggested that rather than reduce emissions in the formula for petrol and diesel, the tax liability should be reduced for the carbon tax included in the fuel price. The following proposal has been submitted for consideration.</p> <p>It is proposed to change the formula to allow for access to the allowance as follows: $X = [(E-S) \times (1-C) \times R] - [D \times T] + [P \times (1-J) \times R] + [F \times (1-K) \times R]$</p> <p>Where D represents the emissions associated with the combustion of petrol and diesel, and T represents the agreed carbon tax tariff within the fuel levy (possibly equivalent to R);</p> <p>The formula should deduct 70% from the sum of combustion and process emissions, because the emission types often take place in a combined way to manufacture the end product, namely steel.</p> <p>It is suggested that a simpler way to account for the tax-free allowances is to use the carbon tax inherent in fuel price (for example 13c/l for diesel) multiplied by the volume of fuel consumed. If the intention is not to provide for the entire tax deductibility of the carbon tax from</p>	<p>Noted. NT will consider the practical feasibility of the proposal and possible options for amending the bill to allow for an additional allowance for liquid fuel related emissions.</p> <p>Noted. NT notes the recommendation to remove the vehicle emissions tax with the introduction of the carbon tax. NT will consider harmonizing the taxes and reviewing the combined impact of carbon related taxes including the motor vehicle emissions tax and possibly phasing down or phasing out the tax. However, this will only be considered during the second phase of the carbon tax, once the effective carbon tax rate is sufficiently high so as to fully account for external costs of carbon emissions. It is misleading to talk about double taxation given the low effective carbon tax rate during the first phase.</p>	

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		<p>these fuels, then the adjustment [1 – C] could be applied.</p> <p>Some stakeholders were of the view that there will be double taxation if both the carbon tax and the existing motor vehicle emissions taxes are implemented. It is suggested that if a carbon tax is levied then the environmental levy when purchasing new motor vehicles should be abolished so consumers do not pay a double tax in respect of carbon tax on vehicles.</p>		
2.9.3	Aviation fuels	<p>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 to ensure regulatory policy alignment and to reduce the administrative burden for operators and governments and minimize potential market distortions. It is suggested that the principles of CORSIA should be extended to domestic aviation as an alternative to carbon taxes so the industry (both international and domestic aviation) can participate in CORSIA. It is recommended 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.</p>	<p>Partially accepted.</p> <p>South Africa supports a global approach to address GHG emissions from the international aviation sector, which might include the use of an appropriate carbon pricing measure, such as an internationally agreed carbon tax. Enforcing regional carbon pricing measures on the international aviation sector (for example, by including the aviation sector in the EU ETS) could be disruptive and distortionary. Emissions from domestic flights will be subject to the domestic carbon tax regime.</p> <p>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</p>	

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			<p>Affairs and the Civil Aviation Authority.</p> <p>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.</p>	
2.10	Carbon Offset allowance	<p>Companies generally support the inclusion of the offset mechanism as a means to drive least cost mitigation. Specific suggestions include that:</p> <ul style="list-style-type: none"> • The offset allowance not be limited and request the removal of the cap on the allowance. • The geographical scope is expanded to include the SADC region. <p>On the other hand, the NGO sector is of the view that the offset allowance should not be permitted as it undermines the efficacy of the carbon tax as a disincentive to emit GHG emissions and hence the GHG emissions reduction policy and should thus be scrapped.</p> <p>Some stakeholders raised concerns on the potential resource constraints within the SARS and the DOE to ensure proper implementation and administration of the offsetting scheme.</p>	<p>The Draft Carbon Tax Bill makes provision for the carbon offset allowance in terms of Section 13. This provides for firms to reduce their carbon tax liability by using offset credits of up to a maximum of 5 or 10 per cent of their process or combustion GHG emissions respectively, as specified in Schedule 2 of the Draft Carbon Tax Bill.</p> <p>A carbon offset is an external investment that allows a firm to access GHG mitigation options at a lower cost than investment in its current operations. Carbon offsets involve specific projects or activities that reduce, avoid, or sequester emissions, and are developed and evaluated under specific methodologies and standards, which enable the issuance of carbon credits.</p> <p>The carbon offset system seeks to encourage GHG emission reductions in sectors or activities that are not directly covered by the tax and/or benefiting from other government incentives. It also serves as a flexibility mechanism that will enable industry to deliver least cost mitigation, i.e., mitigation at a lower cost to what would be achieved in their own operations, and thereby lower their tax liability.</p>	

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			<p>The draft Carbon Offset Regulations and explanatory note were published for public comment and further consultation on 20 June 2016. The Carbon Offset Regulation was developed jointly by the National Treasury, the Department of Energy and the Department of Environmental Affairs in terms of Sections 13 and 20 (b) of the Draft Carbon Tax Bill and sets out the procedure for the use of carbon offsets by taxpayers to reduce their carbon tax liability. The carbon offset scheme will rely primarily on existing international carbon offset standards namely, the Clean Development Mechanism (CDM), Verified Carbon Standard (VCS) and the Gold Standard (GS) and their associated institutional and market infrastructure. However, scope is also provided for the use of local standards/ methodologies where appropriate and independently verifiable.</p> <p>Not accepted. The offset tax-free allowance will remain limited to 10 per cent of combustion and 5 per cent of process emissions to ensure that firms make real efforts to mitigate emissions in their own operations. Limitations on offsets are common in most carbon pricing schemes including China, California, and South Korea for this very reason. Most projects that reduce indirect (scope 2) emissions are already incentivised through other mechanisms, such as the EES tax incentive (12L), that act as an intervention to help companies to reduce both their energy (electricity and fuel) consumption and their Scope 2 (indirect) greenhouse gas emissions.</p>	

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			<p>The Draft Regulation on the Carbon Offset has been revised to allow for certain types of renewable energy projects including some projects under REIPPPP, and small and medium scale renewable energy projects. The revised regulations will be published in July 2018 for public comments and finalisation by the end of September 2018.</p> <p>Noted. The geographic limitation for the carbon offset system is to incentivise emissions mitigation within South Africa first and to minimise the administration costs of broadening the coverage of the system for the first phase of the carbon tax. For subsequent phases of the carbon tax, consideration could be given to expanding the scope of the system to the SADC region and Africa.</p> <p>Noted. Government is developing capacity in the various departments to ensure the effective and efficient administration of the carbon offset system. A carbon offsetting administrative system and framework has been developed by the Department of Energy and will be enhanced through the World Bank Partnership for Market Readiness project.</p>	
2.11	Performance allowance – Company level benchmarks	Some stakeholders were of the view that the current benchmark approach within the prescribed requirements give companies little incentive to improve. There are suggestions that company benchmarks would be more appropriate which, compares current performance of for example, mine to historic performance. Reference is also made to the Davis Tax Committee whereby the Z-factor is only determined by	Not accepted. Company benchmarks will deviate from the policy objective to reward a priori actions taken relative to peers in the industry and create a continuous incentive for entities to consider ways to reduce the carbon intensity of an activity going forward. Government developed a framework and criteria for benchmark development by industry through the Ecofys report which was work-shopped in 2015 and is publicly available on the	

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		considering the historical performance of a specific company that is liable for Carbon Tax, would be a much simpler process	<p>National Treasury website. The report recommended a “one product, one benchmark approach” but given the diverse conditions and operations in the South African industry, allowance for alternative benchmarks could be accommodated. Hence, industry could be allowed to use fall back approaches to benchmark development which will be subject to a peer review process to test their robustness. Determination of the right baseline with regards company benchmarks would be administratively complex given existing information asymmetry between government and industry.</p> <p>The NT has had several engagements with industry and a process for the development and submission of the finalised benchmark reports outlined. Following the envisaged peer review process for the different industry benchmarks which will commence in the third quarter of 2018, a regulation will be promulgated.</p>	