



Death and Carbon Taxes.

South Africa ranks among the top 15 global emitters due to its heavy reliance on coal-fired power generation, resulting in a high carbon intensity.

While Africa contributes only 3% to global emissions, South Africa is responsible for a large percentage of the continent's emissions. As a result, there is significant global pressure for South Africa to reduce its dependence on coal as the window of opportunity to limit global warming closes rapidly.

The South African Carbon Tax Act (Act No. 15 of 2019) was signed into law by the President in May 2019 and came into effect from the 1st of June 2019. This carbon tax is an integral part of Government's package of policy measures to mitigate climate change as outlined in the National Climate Change Response Policy. In the South African context, a carbon tax provides a cost effective and relatively simple carbon pricing solution towards the reduction of carbon emissions. By artificially increasing the effective price of carbon, it is hoped that firms will develop and adopt lower carbon technologies as a business imperative.

There are a growing number of jurisdictions implementing, or planning to implement, a carbon tax or carbon pricing initiatives, including; Argentina, Canada, Chile, China, Colombia, Denmark, The European Union, Japan, Kazakhstan, South Korea, Mexico, New Zealand, Norway, Singapore, Sweden, the UK, Ukraine, Brazil, Brunei, Indonesia, Pakistan, Russia, Serbia, Thailand, Turkey, and Vietnam. The established carbon prices in these countries vary significantly, ranging from as low as \$1 USD to as high as \$130 USD per metric ton of CO₂e. While achieving complete consolidation, such as a globally effective carbon price, may be highly unlikely, enhanced international cooperation is much needed in this space since the diverse array of initiatives pursued by different countries all contribute to the fragmentation of climate actions.

For South Africa, failure to implement emission reduction initiatives would not only hinder access to international green funding but also undermine the competitiveness of South Africa's relatively carbon-intensive raw materials in the global market.

This reality is the reason why projections suggest that the effective tax rate will progressively increase in magnitude to as high as \$50 USD by 2030, as the noose tightens and the leniency in government policy measures diminishes. Indeed, the introduction of the carbon tax has been carried out in a phased manner commencing at a relatively low rate to allow businesses the time to make the necessary structural adjustments to their processes and practices. This poses significant risk to carbon intensive industries such as natural gas, coal mining, oil, metallurgy and cement production. Furthermore, the banking and investment sectors will increasingly consider their exposure to regulatory climate risk within their portfolios and investment processes.

The Carbon Tax

The Carbon Tax Act establishes the necessary framework for the implementation of the carbon tax in South Africa. The initial phase, began in June 2019 and was originally planned to end in December 2022 subsequently, Phase 2 was supposed to run from January 2023 until 2030. However, Phase 1 has recently been extended to 2025.

The South African Carbon Tax is classified as an environmental levy within the Customs and Excise Act (Section 54A). Non-compliance with the carbon tax carries penalties, including the possibility of criminal prosecution. While the carbon tax only focuses on scope 1 emissions, it does at least cover six categories of greenhouse gas emissions, and currently includes a range of relief measures in the form of abatements of up to 95%.

These allowances include;

- A global 60% base tax free allowance
- A 5% reduction for participating in a carbon budget initiative, which involves the compilation and submission of a carbon budget report
- A 10% allowance for "trade exposed" sectors, which are key industries facing global competitiveness pressures such as mining and iron / steel production.
- A 5% performance allowance, measured against industry benchmarks
- A fugitive emissions allowance of 10%
- A carbon offset allowance of 5 to 10%, depending on other achieved allowances

Since South Africa's carbon tax does not have an associated regulatory carbon market, it leverages off of the certification apparatus of eligible voluntary carbon market programs (VCS, Gold Standard and CDM) for participants to reduce tax liability. Carbon offset regulations were developed jointly by the National Treasury, The Department of Mineral Resources and Energy (DMRE) and The Department of Environment, Forestry and Fisheries (DFFE). These regulations determine the eligibility criteria for the offset projects that are to be used to reduce tax liability. Additionally, the DMRE has developed a Carbon Offset Administrative System (COAS) with the mandate of overseeing the operationalization of offset infrastructure, which includes provisions for the development or support of a local carbon offset program or standard.

In theory, this initiative aims to customize the development of local crediting projects; leading to cost reduction, simplification, job creation and the growth of local carbon market capabilities. However, considering the significant advancements in global voluntary markets over the past decade, the initiative is akin to reinventing the wheel. It would be more efficient to leverage the existing and established market infrastructure.

Challenges

As with any policy development, the implementation of carbon pricing mechanisms presents its own set of challenges, especially concerning implementation, securing and sustaining corporate support, and promoting broader strategic thinking. To ensure effective implementation, comprehensive approaches that prioritize stakeholder inclusion and employ clear communication strategies are essential. Additionally, technically informed decision-making processes and practical actions are crucial. This includes; accurately assessing emission reductions achieved thus far, ensuring appropriate price levels, efficient reimbursement of rebates, defining entities' understanding of operational control and liability, and transparently allocating tax revenue towards circular economy and green initiatives.

Preparing for the Inevitable

It is essential for companies to understand their GHG mandatory reporting requirements, in order to properly assess their carbon tax liability. Furthermore, progressive and "at-risk" companies should view the full tax value of their emissions, without the current allowances, as this represents their **real risk**. The amounts saved through the current allowances should then be ring-fenced into a feeder fund from which to develop approved carbon credit and carbon offset projects. Just as the old adage goes that "nothing is certain but death and taxes," it holds true that whether or not an efficient price for carbon is attained, there is an undeniable cost associated with emitting carbon, which will be levied on emitters.

XMS has a Multi-Disciplinary Team of Advisors, Associates and Consultants enabling us to explore opportunities to transition companies from being carbon powered to empowered through carbon.

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