CATALYST solutions

Budget Observations – Business Incentives and Carbon Tax

The Minister of Finance, Mr. Tito Mboweni, presented National Treasury's annual 2021/22 budget earlier this afternoon. The 2021 Budget indicated the largest ever tax shortfall expected for the current financial year. Despite the shortfall no significant tax increases were announced and a vision of a broadened corporate income tax base with a reduced tax rate was made public.

2021 Budget Observations

Business Incentives Updates

- **Section 12I Industrial Policy Project Tax Incentive** – The Covid-19 pandemic is having a detrimental effect on some of the approved projects and Government will consider amending the timeframes for projects to bring assets into use.
- **Research and Development** - The R&D tax incentive is still in force until at least October 2022. Government will be engaging with industry during the course of 2021 to obtain public comment before making a final decision in the 2022 budget speech. We are working closely with the Department of Science and Innovation on the discussion document and will keep you informed.
- **Support Program for Industrial Innovation (SPII)** – The grant which had significant budget cuts during Covid, has now received a boost in its budget. The medium-term budget is allowing for a significant ramp up in the support of innovation through this incentive.
- **DTIC Programmes** – Ongoing support will be provided for existing business incentives with R17.1 billion in grant funding allocated to the Department of Trade, Industry and Competition over a three year period.
- **Section 12J** – The Venture Capital Companies incentive was found to not achieving its objectives as part of a review process undertaken by Government and will not be extended beyond the current sunset date of 30 June 2021.
- **Employment Tax Incentive** – The definition of "employee" as per the Employment Tax Incentives Act (2013) will be amended to ensure work is performed in terms of an employment contract adhering to the recordkeeping provisions in accordance with the Basic

Conditions of Employment Act (1997). The amendment will be effective from 1 March 2021 and was introduced to counter perceived abuse of the incentive.

- **Tourism Equity Fund** – The Tourism Equity Fund launched on 26 January 2021 was specifically mentioned with R540 million allocated for the acquisition of shares in tourism enterprises by black-owned and economically viable enterprises.
- **Urban Development Zone** - The urban development zone incentive will be extended for two years beyond the current sunset date of 31 March 2021 while a review of the incentive is completed
- **Review of existing incentives** – As per the Davis Tax Committee's recommendation, all business tax incentives are being reviewed with the aim of repealing the redundant, inefficient or inequitable ones.

<u>Carbon Tax Related Updates</u>

- **Carbon tax rate** – The carbon tax rate will increase by 5.2% from R127 per tonne CO2e in 2020 to R134 per tonne CO2e in 2021.

- **Carbon budget allowance –**
  - The voluntary carbon budget system has been extended, effective from 1 January 2021 to 31 December 2022. Prior to the end of March 2021, The Department of Environmental Affairs, Forestry and Fisheries ("DEFF") will communicate the requirements for companies to access the carbon budget allowance for this period.
  - It is proposed that the reference to participating "before the tax period" in the Carbon Tax Act be replaced with a specific timeframe for the carbon budget (1 Jan 2021 to 31 Dec 2022).
  - In addition, it is proposed that from 1 January 2023, when carbon budgets become mandated, companies will no longer be able to access the 5% carbon budget allowance. From this date, DEFF is considering imposing caps on the carbon emissions of companies.

- **Clarifying renewable energy premium beneficiaries** – It is proposed that, from 1 January 2021, only entities that conduct electricity generation activities and purchase additional primary renewable energy directly under the REIPPP or from private IPPs with a PPA are eligible to claim the renewable energy premium tax deduction for their renewable energy purchases.

- **Aligning fugitive emissions activities covered under Carbon Tax Act** – It is proposed that an additional category be included under the Carbon Tax Act to cover the IPCC code 1B3 activities for other emissions from energy production.

- **Sequestration** –
  - To address possible double benefits from the same sequestered emissions, it is proposed that the definition of GHG emissions sequestration be amended to remove carbon capture and storage in geological reservoirs.

- In November 2020, DEFF published a methodological guideline for quantifying greenhouse gas emissions sequestration in the forestry industry. Due to concerns about the permanence of sequestered emissions in harvested wood products and the robustness of the available emissions calculation methodologies, it is proposed that only actual forestry plantation sequestered emissions should be eligible for the deduction under the Carbon Tax Act.

- **Waste Tyre GHG emissions** – DEFF will develop appropriate emission factors for the combustion of waste tyres for possible inclusion in the 2022 Budget Review.

- **Updates to activities in the Carbon Tax Act** – Amendments were proposed to some activities listed in the Carbon Tax Act in terms of the thresholds, the inclusion of new activities, and previously exempted activities that are now reportable to DEFF. These updates are aligned with the amendments to the National Greenhouse Gas Emission Reporting Regulations and will take effect from 1 January 2021.

- **Carbon Tax for petrol and diesel (and some other fuels)** – The carbon tax is built into the fuel levy. The levy for 2021 will increase by 1 cent to 8 cents and 9 cents per litre for petrol and diesel respectively from 7 April 2021.
- **Carbon Tax Revenue** – The revenue from Carbon Tax for the 2020/21 year is estimated to have been R630 035 000 and the estimate for the 2021/22 year is R656 206 000.

Other Matters

- **Bio-based plastic bags** – Plastic bags are currently taxed at 25 cent per bag, but a reduced levy of 12.5 cent per bag will apply to bio-based plastic bags.

- **Gazetting of three energy projects** – the Emergency / Risk Mitigation Power Purchase Procurement Programme, the Small Independent Power Producer Programme (Small IPP Programme) and the Embedded Generation Investment Programme have been gazetted. The projects are expected to create an estimated 2 569 MW of electricity generating capacity.

Concluding Comments

Government is in the process of systematically reviewing business incentives but companies still have an opportunity to take advantage of the available tax incentives and grant support on offer. National Treasury has made a proposal to lower the corporate income tax rate to 27% for companies with tax years of assessment commencing on or after 1 April 2022 and this is good news from a business tax relief point of view. This will however be done alongside a broadening of the corporate income tax base by limiting interest deductions and assessed losses.

From a carbon tax and greenhouse gas emissions point of view, companies have to be prepared for changes from a regulatory point of view in line with South Africa's National Climate Change Adaptation Strategy (NCCAS) and the National Climate Change Bill.

The carbon tax (introduced in 2019) is one of the mechanisms that is aligned to South Africa's strategy for transition to a low carbon economy. Carbon taxpayers can expect for the rates of taxation to go up post 31 December 2022 with certain carbon tax allowances being phased out and/or being reduced. Further to this, from 1 January 2023, DEFF is considering imposing caps on the carbon emissions of companies.

It is therefore becoming increasingly important for companies reduce greenhouse gas emissions. Companies must also take advantage of, and maximize the current saving opportunities on offer in the form of carbon tax allowances, sequestration and benefits claimable under the section 12L energy efficiency tax incentive.

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