

24 JUNE 2021

TAX & EXCHANGE CONTROL ALERT

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Giving the green light – opportunities for renewable energy capex following increased embedded electricity generation limit

In response to the persistent energy constraints faced by South Africa, the President has made the eagerly anticipated announcement that the government intends amending the Electricity Regulation Act 4 of 2006 to allow for the construction of embedded generation projects of up to 100MW, without a generation licence. This crucial policy directive will broaden the ability for self-generation to meet commercial needs in an environment of unstable supply. The potential for renewable energy projects to be part of the energy solution is bolstered by the availability of capital allowances in the Income Tax Act 58 of 1962 (Income Tax Act).

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Giving the green light – opportunities for renewable energy capex following increased embedded electricity generation limit

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In the [Tax Alert](#) of 18 June 2021, the carbon tax considerations raised by the proposed increase in embedded generation projects were discussed, including the opportunities presented for carbon credit generation through renewable energy projects.

The Income Tax Act contains capital allowances aimed at assisting the renewable energy sector through accelerated capital expenditure deductions for various types of renewable energy generation infrastructure builds and certain types of ancillary structures. Although these incentives are not new, they present a welcome net cost reduction method in constructing new renewable energy generation projects or improving existing sites.

The Renewable Energy Capex Allowances - sections 12B and 12U

Section 12B provides for a deduction of the lesser of the actual and arm's length costs of acquiring and installing any machinery, plant, implement, utensil or article used in the types of generation projects listed in section 12B(1)(h) (Generation Asset). The following types of renewable generation projects may benefit from the allowance:

- wind power;
- photovoltaic solar energy of more than 1 megawatt;
- photovoltaic solar energy not exceeding 1 megawatt;
- concentrated solar energy;
- hydropower to produce electricity of not more than 30 megawatts; and
- biomass comprising organic wastes, landfill gas or plant material.

To claim the allowance the Generation Assets must be brought into use for the first time, for the taxpayer's trade and be owned by the taxpayer or purchased under a qualifying instalment credit agreement.

The capital allowance for the costs of Generation Assets is spread over three years on a 50%/30%/20% basis. However, an exception is made for photovoltaic solar energy not exceeding 1MW which is deductible fully in the first year of expenditure.

Any foundation or supporting structure which is designed for the Generation Asset and built for the purpose of the generation project ought to be deemed to be part of the Generation Assets subject to the allowance and claimable under the section.

Giving the green light – opportunities for renewable energy capex following increased embedded electricity generation limit...*continued*

The availability of the capital allowances for renewable energy generation projects and the resultant reduced tax cost of such investments may just be the green light investors have been waiting for to tackle South Africa's energy shortages.

Where improvements, excluding repairs, are made to Generation Assets, foundations or supporting structures, then an allowance under 12B(1)(i) on the same 50%/30%/20% basis will be granted to the taxpayer for the costs of purchase and installation.

Section 12U provides for capital allowances for roads and fencing used in the generation of electricity greater than 5MW from the following sources:

- wind;
- solar;
- hydropower to produce more than 30MW; and
- biomass comprising organic wastes, landfill gas or plant material.

The section 12U allowance is granted in full in the year of expenditure. It covers improvements to the roads and fencing related to the generation project, as well as the foundations or supporting structures to such roads and fencing.

Comment

The renewable energy capital expenditure allowances are not new and are based on criteria familiar to South African taxpayers. Similar requirements have historically been and are currently applied for the

allowances for expenditure on farming implements. Therefore, SARS' position on a particular project or Generation Assets qualifying for the allowance is predictable.

It is also notable that the requirement that the Generation Assets be applied in taxpayer's trade does not mean that the taxpayer's business must necessarily be the sale of electricity. It will likely be sufficient that the electricity generated is used by the taxpayer's business. The allowances may also potentially be claimed where the expenditure is incurred prior to the business beginning to trade, in the circumstances outlined in the sections of the Act.

The proposed increase in the embedded generation thresholds presents an opportunity for new generation projects to come online and existing projects to be improved to increase their output capacity. Both of these will require capital investment. The availability of the capital allowances for renewable energy generation projects and the resultant reduced tax cost of such investments may just be the green light investors have been waiting for to tackle South Africa's energy shortages.

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